The Centrality of Relationships in Microfinance: A Case Study of Two MFOs in South India

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By

Charu Vijayakumar

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Project Advisor: Professor Irfan Nooruddin, Department of Political Science

Abstract

Microfinance is by nature a social banking venture. As such, the role of relationships is central to the approach and delivery mechanisms of the financial services. Although many studies have been conducted in regards to the efficiency of microfinance, the relationships that form and affect the approach and delivery mechanisms of microfinance have been largely overlooked. In order to remedy this oversight and better understand the relationship structures in the practice of microfinance in India, this project analyzes two particular relationships; the relationship between the microfinance providing organization and its clients, and the intra group relationships within the client focus groups. The field research consists of a case study of two microfinance providing organizations in the south Indian state of Tamil Nadu. The data illustrates that there are two key features that are characteristic of each relationship. The data analysis indicates that these features not only form the basis of these relationships, but can work both in the favor of and in some instances against the sustainability of one or both of the relationships considered. Understanding the fabric of these relationships will enable those in the field of microfinance to provide financial services to their target clientele in a more effective and sustainable manner.

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Chapter 1

Microfinance as a Tool of Economic Development in India

Poverty is the deprivation of capabilities. Amartya Sen writes, “While it is important to distinguish conceptually the notion of poverty as capability inadequacy from that of poverty as loweness of income, the two perspectives cannot but be related, since income is such an important means to capabilities.”[1] Lowness of income not only deprives one of the capabilities that Sen mentions, such as education and healthcare that would provide one with greater earning power, but it also deprives one of access to resources that would allow the utilization of such capabilities. As such, poverty becomes a vicious cycle that is self-perpetuating and difficult to break free from, hence becoming a poverty trap. Economic development therefore attempts to address these deprivations and offers venues for the enhancement and utilization of these capabilities.

The term “development” has been interpreted in many different ways. The most commonly used rendition of the term in the field of international development implies that development is the introduction of something new for the purposes of social, economic, or cultural advancement. If traced back to the roots of the word itself, however, we find that the true meaning lies in that of the already existing. Contrary to popular usage, development in essence means to uncover what is hidden beneath. The term “derives from two Old French words; *de*, from, away, and *voloper*, to wrap; de-voloper, to unwrap.”[2] One of the few fields in which the term is used to reflect its true meaning is photography - developing film is the process of

[1] Sen, Amartya. “Development as Freedom,” pg. 90.
[2] Selvamony, Nirmal. “De-developing Society: A Case for Tradition,” pg. 86

uncovering what exists beneath the surface.[3] Although the field of economic development often uses the term as a substitute for improvement, advancement, or expansion, in light of its true meaning, it can be interpreted to mean the process of uncovering true potential that has been obscured by the lack of accessibility to certain resources. In light of this interpretation, microfinance is an increasingly popular tool of economic development and poverty alleviation schemes throughout the world that aim to facilitate access to capability-enhancing resources.

Although microfinance, microcredit, microlending, and other similar terms are often used interchangeably, microfinance is the term that is most comprehensive, including savings, loans, and insurance, and as such is the term that will be used throughout this thesis. Microfinance can be defined as an attempt to improve the access to small loans and deposits for poor households that are not eligible to utilize traditional banking opportunities due to their lack of physical collateral.[4]

Previously, the poor were thought to be un-bankable by commercial banks. Traditional banks argued that poor people, without collateral, did not have an incentive or the ability to repay loans and thus would not be suitable financial clients. Consequently, they were systematically excluded from being given the opportunity to do so formally. In 1976, however, as the most popular story of microfinance goes, the man credited as the father of microfinance (especially in South Asia), Muhammad Yunus, challenged this notion and proved that the poor were indeed bankable. As he describes his experience, he relates that his work "became a struggle to show that the financial untouchables are actually touchable, even huggable."[5]

While he was the head of the economics department at Chittagong University in Bangladesh following the 1974 famine, Muhammad Yunus became involved with poverty

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[3] Selvamony, Nirmal
[4] Schriener,M. and Colombet,H.
[5] Yunus, Muhammad. "Banker to the Poor: Micro-Lending and the Battle Against World Poverty," pg. 57

reduction efforts. It was during one of his visits to a rural village that he realized that one of the major problems facing the poor of his country was the lack of access to formal credit. As such, the poor were forced to take out loans from local moneylenders who charged high interest rates and required the borrower to make repayments with the profits. Giving a small collateral free loan of $27 dollars from his own pocket to a group of 42 women in a village, Yunus found however, that the poor do repay their loans, social collateral can be substituted for traditional collateral, and that micro loans make a substantial difference in the economic opportunities of the poor.[6] Although Muhammad Yunus was not the first person to experiment with microfinance, he popularized it, especially in South Asia, and made it mainstream through the founding of the Grameen Bank and the winning of the Nobel peace prize for his endeavors.

In Bangladesh and other parts of the world micro financing has been in practice for a long period of time. Provision of credit and other financial services on a micro level and in non traditional ways, however, has not always been referred to as 'microfinance.' This comprehensive term has been relatively newly coined to encompass the various forms of non commercial financial services offered to the non traditional banking clients. The existence of microfinance in Europe has been dated back to the substantial increases in the poverty levels in the 16th and 17th centuries. The early history of microfinance in Ireland has its roots in the time period spanning 1720 to 1950.[7] Similarly, in Germany, the first wave of microfinance was present in the late 1700s through the existence of thrift societies and communal savings funds. And the second wave appeared after the year noted as the hunger year of 1846-47.[8] As such, the utilization of informal and semi formal modes of financial services is neither a new nor a geographically-exclusive practice.

[6] Yunus, Muhammad
[7] Seibel, Hans Dieter. Does History Matter? The Old and the New World of Microfinance in Europe and Asia.
[8] Seibel, Hans Dieter

Historically in India, three major forms of informal financing have been utilized: financial services provided through moneylenders, chit funds, also known as rotating savings and credit associations (ROSCAs), and merchant banking.[9] Of the three forms of financing, moneylenders who provide loans from their personal resources are the oldest form of financial services. This form of informal financing became an organized and regulated profession approximately 1700 to 2200 years ago. Similarly, chit funds also became increasingly integrated into the formal financial sector starting with the Travancore Chit Act of 1945. This act was followed by other laws and regulations, especially at the state level, providing the specific form of financial service legal status as non banking financial intermediaries.[10] The most comprehensive of the three, merchant banking, was the provision of financial services consisting of lending, deposit taking, and other financial services that emerged in India as early as the first millennium B.C.[11]

Although these various forms of microfinance have existed in India for a long time, rural access to finance has been very limited. Much of the access that existed was through moneylenders. Given the system of land revenue that existed, however, indebtedness of the rural poor increased as moneylenders exploited the limited micro-financial options to which the rural poor had access through high interest rates and other forms of rent seeking.[12] In addition, India's early macroeconomic reforms such as the first three Five Year Plans ranging from 1951 to 1966 emphasized India's self reliance and concentrated efforts on rapid industrialization. Such investment came and still continues to come at the expense of the rural and agriculture sectors.[13]

[9] Seibel, Hans Dieter
[10] Seibel, Hans Dieter
[11] Seibel, Hans Dieter
[12] Seibel, Hans Dieter. Research shows that premium for risk due to systemic shocks and opportunity cost are two factors that contribute to such high interest rates charged by moneylenders.
[13] Fan, S., Chan-Kang, C., and Mukherjee, A. "Rural and Urban Dynamic and Poverty: Evidence from China and India."

This financial environment left India with a largely underserved and financially underdeveloped rural population.

The functions of financial markets, as described by Meyer and Nagarajan, are to ameliorate risk, allocate resources, monitor managers and exert corporate control, mobilize savings, and facilitate the exchange of goods and services.[14] Therefore, without the presence of financial markets in the rural areas of India, as noted earlier, the rural poor were not only excluded from the access to credit to further their entrepreneurial activities, but were also cut off from utilizing the supplemental services provided by financial markets. This lack of access to the financial markets consequently also prevented the rural population from being involved in capital accumulation processes and technological innovations, the two factors that define economic growth. Thus, economic growth was stunted in the rural areas.[15]

In order to remedy this issue of a large portion of the population being unable to access basic financial services in a secure and stable manner, the national government, local governments, and various organizations began to implement borrowed and innovative measures. For example, in 1969, the Union government of India nationalized fourteen private banks, implemented a requirement that called for the opening of two rural branches for every urban branch, and enacted a mandatory system which required a certain percentage of priority sector lending.[16] Between the years of 1973 and 1985, the number of bank branches in rural areas increased on average 15.2% per year. In contrast, the growth rate of the number of bank branches in urban areas was 7.8%. Presently in India, there are more than 32,000 rural branches of commercial banks and regional rural banks, approximately 14,000 cooperative bank branches, 98,000 primarily agricultural credit societies, post office networks with outlets that are required

[14] Meyer, R. and G. Nagarajan. "Rural Financial Markets in Asia: Policies, Paradigms, and Performance."
[15] Meyer, R. and G. Nagarajan
[16] Seibel, Hans Dieter

to focus on deposit mobilization, and many non bank finance companies.[17] Although these measures largely failed to reach the target audience, the financial and banking system in particular in India was evolving over time to attempt financial widening and deepening.[18]

Although India has a very diversified rural financial infrastructure as the initiatives of the late 1960's thru mid 1980's illustrate, a large portion of the rural poor were/are not being served effectively or efficiently. Thus, in an effort to work with the already existing infrastructure and build upon features that can be improved innovatively, the linkage between the formal and non-formal financial sectors was created. Although India is heralded for the bank linkage program that is widely used to provide microfinance services, the linkage program is a feature borrowed from the Indonesian banking model. In 1988, the central bank of Indonesia implemented a pilot project linking banks and self-help groups (SHGs) in Indonesia. Hearing about the success of the project, Mr. Y.C. Nanda, the General Manager of the National Bank for Agriculture and Rural Development (NABARD) was inspired to replicate the system in India to serve the rural population. When presented with the choice of pursuing a national strategy based on the Grameen model as the new national banking structure, NABARD argued to follow the bank linkage program instead.[19]

NABARD argued three focal points in promoting the bank linkage system:

1. Linking SHGs with banks would be using the infrastructure of both the banks and the social organizations that already existed.[20] It would be a more suitable model for India where a vast network of rural bank branches already existed but were not reaching the rural poor and

[17] Basu, Priya and Srivastava, Pradeep. "Scaling-Up Microfinance for India's Rural Poor."

[18] Basu, P. and Srivastava, P.
[19] Seibel, Hans Dieter
[20] Seibel, Hans Dieter

where SHGs functioned on their own but were not linked to a formal financial service provider in any capacity.

2. The promotion of microfinancial services should be led by savings and not solely credit mechanisms.[21] Thus, the SHGs are required to promote actively a savings habit prior to being eligible to take loans from a formal or semi-formal financial institution.

3. The provision of credit should be through banks, formal financial institutions, rather than donor resources.[22] The provision of credit is a product of the financial market. As such, it should be run by the market forces and not donor resources that are not sustainable and subject to conflicting interests and incentives. As such, a new model for the provision of microfinance services was born in India.

The various entities involved in providing microfinance services throughout India range from completely informal entities such as moneylenders, to semi-formal financial institutions such as non -profit and non-governmental institutions, to formal financial banking institutions. Although SHG-bank linkage programs comprise the majority of the microfinance activities in India currently, other strategies are also utilized to provide the same services. Although not as popular, the Grameen model promoting the joint liability group is also utilized in providing microfinance in India. Unlike the SHG-bank linkage model, the Grameen model does not stress the pre-requisite of a savings habit. The strategy is defined by the implementation of a joint liability system which is substituted for the lack of physical collateral. This social collateral method ensures repayments not through the threat of losing physical collateral but rather through the group liability system where if one member defaults on her loan, the other members are

[21] Seibel, Hans Dieter
[22] Seibel, Hans Dieter

obligated to repay it for her. Although not defined by the prerequisite of establishing a savings habit, often a joint liability strategy also incorporates some sort of a savings mechanism.

Research Question

Microfinance in theory and practice is very much a social banking system. As such, it derives its specific mechanisms from the surrounding environment. It is a system dependent upon and catered to various relationships. This basis of a relationship-centered financial system subjects the activities of microfinance to evolve over time to cater to the particular needs of the population in a given economic environment. As has been presented in the historical context of India, the financial services offered to the rural populations has been varied and has changed in regulatory measures over time. The purpose of this study is to analyze the role of relationships in the approach and delivery of microfinance in India. The two primary relationships that will be focused on are the relationships between the microfinance providers and their clients and the intra-group relationships within the microfinance utilizing client groups. This study will draw upon the existing literature on microfinance available and also upon the researcher's field work which presents a case study of two microfinance providers in Tamil Nadu, India: S.M.I.L.E. Microfinance Limited and Bullock-Cart Workers Development Association Finance Limited (BFL).

S.M.I.L.E. Microfinance Limited is a microfinance-providing organization whose mission is to empower poor women to become economically self reliant. The organization was initially founded in 1999 as a Trust by the social entrepreneur Dr. N. Sethuraman. In the year 2004, the organization was transformed into a non-banking finance company (NBFC) to facilitate the provision of microfinance services. Currently, S.M.I.L.E. Microfinance Limited has eighty eight branches operating in thirteen districts throughout the state of Tamil Nadu. It serves the urban poor in and around the city of Chennai, and the rural and semi-urban poor in nine other districts.[23]

S.M.I.L.E. Microfinance Limited uses the joint liability group model, also known as the Grameen model. As such, the organization provides "financial assistance to the individuals in a group…on the strength of the group's assurance."[24] As such, the loans are provided to the clients on the basis of the joint liability of the group members in a particular group. As of 2008, the most recent available figures, S.M.I.L.E. Microfinance Limited's number of outstanding loans was 129,546.[25]

Clients claimed that the loans taken by S.M.I.L.E. Microfinance Limited clients are predominantly used for income-generating purposes with a small fraction being used for consumption purposes. The income-generating activities are broadly categorized as agriculture, allied agricultural activities (dairy, sheep-rearing, etc.), small business ventures (tea shop, etc.), retail trade (fruit and vegetable vending), self-employment ventures (bicycle shop, watch repair, etc.), and village and cottage industries (carpentry, pottery, etc.). All the loan products, excluding the destitute loans[26], offered by the organization have a weekly repayment schedule. The micro loans increase in amount as the loan cycle increases but still remain on a weekly repayment schedule. All loans, excluding the destitute loans, are based on a flat twelve percent annual interest rate.[27]

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[23] S.M.I.L.E. Microfinance Limited Website
[24] S.M.I.L.E. Microfinance Limited Website
[25] MIX Market Website
[26] Destitute loans are much smaller and have a more flexible repayment schedule. They are 1000 rupees loans given for a one year period with repayments made in convenient installments with zero percent interest being charged.
[27] S.M.I.L.E. Microfinance Limited Website

The second microfinance providing entity, BFL, studied for this project is a subsidiary of the larger non governmental organization, Bullock-Cart Workers Association (BWDA) that was founded in October of 1985. Although the organization started its involvement in the provision of microfinance services in 1992, in August of 2003 it formed the separate entity of BFL in order to service the increasing demand for credit and expand the provision of microfinance services more effectively.[28]

BFL, in continuation of the structure that was utilized by BWDA during the initial stages of the microfinance program, uses the self help group model to service its clients. Each self help group consists of fifteen to twenty group members. Although the BFL staff contributes to the process by motivating the potential group members to form the self help groups, the groups are formed by the members themselves. BFL then facilitates their access to credit and savings mechanisms through the bank linkage program where clients can obtain bank direct loans and through the revolving fund generated through the savings mechanism implemented as a mandatory requirement of the existence of a self help group.

Currently, BFL has branches operating in ten districts around Tamil Nadu. As of 2005, BFL served 6,772 self help groups equaling to 60,057 individual clients. Between 2004 and 2005, the organization disbursed 334.3 million rupees (7.42 million USD) in loans. Since 2005 however, the group has increased the number of self help groups it is serving and the amount of loan it is disbursing on an annual basis.[29] As of 2010, BFL has cumulatively serviced 23,889 SHGs equaling to 437,317 individuals. These services led to an outstanding portfolio of 1.15 billion rupees (25 million dollars) as of March 31st, 2010. The majority of the BFL loans are used

[28] BWDA, 20th Year Souvenir Publication
[29] BWDA, 20th Year Souvenir Publication

to cover activities in the rural areas such as agriculture, micro industry, petty trade, other income generating schemes, and rural housing needs, etc.[30]

Although both S.M.I.L.E. Microfinance Limited and BFL are microfinance-providing organizations operating in the south Indian state of Tamil Nadu, there are core differences in the approach and delivery mechanisms that each utilizes. These differences range from the type of group model to the nature of the interest rates that each organization chooses to use. Despite such structural differences, however, since they are organizations involved in the field of microfinance, a social banking venture, the role of relationships remains central to both of their approach and delivery mechanisms.

Social banking implies that there is an inherent difference in the practice of providing financial services. Commercial banks measure their success through profits; microfinance-providing institutions measure their success through the number of clients successfully served, therefore, through outreach and sustainability. This focus on economic development of the traditionally financially underserved people is what distinguishes microfinance as a social banking mechanism. In order to implement a people-centric banking mechanism, relationships must be forged, fostered, and maintained. Both the relationship between the microfinance-providing organization and its clients and the intra-group relationship within the client groups are defining aspects of microfinance as a social banking venture. As such, regardless of the particular approach and delivery mechanisms used by each organization, a people-centric banking venture necessitates a relationship-centric banking system.

Differences in the approach and delivery of microfinance services do not displace the centrality of the role of relationships; rather, they strengthen or weaken these two relationships to

[30] The up-to-date information was obtained from a report compiled by the BFL staff upon request because their website was temporarily disabled

varying degrees. Thus, the primary question presented in this paper is: which microfinance-providing organization, S.M.I.L.E. Microfinance Limited or BFL, displays stronger relationships based on the particular approach and delivery mechanisms each one utilizes? The two relationships in question are: the relationship between the organization and its clients and the intra-group relationships within its client groups

In order to answer this question, it is necessary to analyze both the existing literature on the topic of microfinance as well as the field research of these particular two microfinance-providing organizations. In order to understand why the organizations use the particular approach and delivery mechanisms that they do involves a broader understanding of the field. As such, the next chapter provides a literature review outlining the primary findings by scholars of microfinance both internationally and in India in regards to the centrality of the role of relationships in the practice of microfinance in India. Although there is no literature directly analyzing this topic, certain themes will be highlighted that will contribute to developing a framework that will help answer the primary question presented in this thesis.

The latter half of Chapter 2 presents the primary argument of this thesis. It explores the importance of the central nature of relationships in the practice of microfinance and the specific features that characterize each of the two primary relationships identified. This section serves as a framework within which the analysis of the field research is based.

Chapter 3 is divided into two sections. The initial section of this chapter describes the methodology that led to and was followed in the field research carried out in the Tamil Nadu, India with the staff and clients of the two microfinance-providing organizations: S.M.I.L.E. Microfinance Limited and BFL.

The second section of Chapter 3 presents the analysis. This section is further divided into two sub-sections. The first sub-section analyzes the features characteristic of the relationship between the microfinance-providing organization and the clients drawing on the literature and more prominently on the field research. The second sub-section uses the same vein of analysis to analyze the features characteristic of the intra-group relationships within the client groups of both organizations.

Chapter 4 ties together the previous three chapters by offering a conclusion. This chapter uses the information gained from the analysis section which draws upon the previous four chapters to answer the primary question of which organization does in fact have stronger relationships.

Chapter 2

Literature Review

Although there is a vast array of literature available on microfinance, there is hardly any literature specifically focusing on the centrality of the role of relationships in the field of microfinance. Much of the existing literature, however, shares similar themes. These themes revolve around the basic and core characteristics that define the concept of offering financial services to an economically disadvantaged population who have largely been considered un-bankable by the traditional banking systems. Therefore, these themes include why microfinance is a necessary financial mechanism for the poor, how the microfinance provider and non traditional client build a business relationship, and how microfinance services are sustained given the clients' lack of traditional collateral. As such, the existing literature provides a framework of the approach and delivery mechanism of the practice of microfinance.

The purpose of this study is to analyze the central role of relationships in the approach and delivery of microfinance in India. Specifically, two particular types of relationships will be addressed, the relationship between the microfinance providers and their clients and the intra-group relationships within the client groups. In order to study these relationships within the framework of the approach and delivery mechanism of the practice of microfinance, each relationship is analyzed in the context of the particular mechanisms that characterize that relationship.

Thus, the study will be structured by the following framework:

1. The relationships between the microfinance providers and their clients are characterized by two main features:

a. The clients' desire for financial access and reliability and

b. The process of information-based lending.

2. Similarly, the intra-group relationships within the microfinance client groups are characterized by two main features:

a. The two dominant group models in India and

b. Participation and cooperation within the client groups.

Relationship between the Microfinance Organization and the Clients

The Clients' Desire for Financial Access and Reliability:

Unlike formal commercial financing institutions, microfinance providers offer loans and other financial services to poor households. Although both informal and formal financing offer access and reliability, they do so on different terms. In order to compete with moneylenders, microfinance organizations must project the image of being more reliable than longstanding moneylenders in a community. Well established commercial banks provide the security of functioning by the rules consistently and remaining functioning even when certain types of shocks affect a few clients at the same time. However, the prerequisite of possessing physical collateral and detailed paperwork to be able to take out loans excludes the poor sector of the population that does not own land or other forms of capital that can be used as physical collateral and cannot afford to go through the paperwork. Moneylenders, on the other, hand offer 'door step' service in providing the loans albeit at extremely high interest rates. Moneylenders do not require prerequisites such as commercial banks do but will do business with any client willing to pay their exorbitant interest rates. Access and reliability are both features that the poor value, much like those in the higher socio-economic cohorts. Because of the structure both the formal and informal financial systems present, however, neither one offers both access and reliability as befits the poor.

The various microfinance approaches that are practiced combine the convenience and flexibility of informal finance and the safety and reliability of formal finance to serve the financial needs of the India's poor[31]. Therefore, the practice of microfinance borrows from each form of finance, formal and informal, the aspects that are lacking in the other, and combines them to create an optimal option for those who are not efficiently served by either one exclusively. Thus, the relationship between the microfinance provider and their clients is built upon this basic economic convergence of supply and demand.

As Richard Rosenberg states, the issue of poverty is not just a matter of low incomes for households, but also a matter of the irregular and uncertain nature of the incomes.[32] As the international poverty line defines it, poverty is living on less than $2 dollars per day, and extreme poverty is living on less than $1 per day. However, "One of the least remarked on problems of living on two dollars a day is that you don't literally get that amount each day."[33] The poverty line of two dollars a day is merely an average. Thus, sometimes the poor make more than that, sometimes less, and sometimes they have no income at all. Therefore, the effects of poverty are not only characterized by the lowness of income, but are made worse by the uncertainty of an irregular flow of income. As such, the poor value financial services that are both accessible and reliable.

Although accessibility is a problem for the poor in all geographic locations, those in rural areas often face greater accessibility issues. This is due to the sparse populations spread over the

[31] Basu, P. and Pradeep, P.
[32] Rosenberg, Richard. "Does Microcreidt Really Help Poor People?"
[33] Collins, D., Morduch, J., Rutherford, S., and Ruthven, O., <u>Portfolios of the Poor: How the World's Poor Live on $2 a Day</u> .

area, the long distances in between each service provider and the clients' homes, the lack of infrastructure as rural areas are often neglected in favor of urban development, the high transaction costs associated with the lack of infrastructure, and the high risk in offering financial services to people who face so many obstacles.[34] Thus, as Colombet and Schriener state, the poor cost more to serve. Unlike clients of the commercial banking system, the poor demand small loans for short periods of time. However, since they do not have a constant income from a salaried job or do not possess or have access to physical collateral, they are unable to guarantee creditworthiness. As such, the cost of serving the poor financially is higher and hence they pay more.[35]

As has been established, the poor value accessibility and reliability. However, these are not short term mechanisms. The poor value these characteristics as components of long term stability.[36] For microfinance to work in the long term and remain sustainable, the approach and delivery mechanisms of microfinance must be grounded on market principles and not solely on supplementary funding such as subsidies.[37] This convergence of the call for long term stability mechanisms for the poor and the use of market principles in the delivery of financial services translates to higher service costs for the microfinance providing institution. Microfinance experts point out that the poor are aware of the higher costs and are willing to pay for them if it means permanency and reliability in financial services for them.[38,39] As such, the desire for financial access and reliability of the poor defines a crucial characteristic of the relationship between the microfinance service provider and the clients of that organization.

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[34] Schreiner, M. and Colombet, H.
[35] Schreiner, M. and Colombet, H.
[36] Tiwari, P. and Fahad, S.M. "Microfinance Institutions in India."
[37] Tiwari, P. and Fahad, S.M.
[38] Gonzalez-Vega, C. "Microfinance: Broader Achievements and New Challenges."
[39] Rosenberg, Richard

Information-Based Lending

In commercial banking systems, as was established earlier, the offering of financial services is based on the creditworthiness of the client that is signaled by the client's possession of or access to physical collateral. As such, the loan system can be called collateral-based lending. In microfinance however, the clients for the most part cannot afford such evidence of their creditworthiness. Instead, their creditworthiness is determined through information gathering by the microfinance service providers. A relationship of trust is forged between the MFO and the client-based on this information. As such, this type of lending is also often called relationship-based lending.[40] The necessary information is gathered through the MFO's loan officer's interaction with the neighbors of the prospective clients.[41]

Once prospective clients are identified, their neighbors are approached and questioned in order to assess the financial habits of the prospective client, his/her character and credibility, family situations and income, and willingness and ability to pay back loans. As the goal of most microfinance organizations is to provide loans in order to support micro enterprises, this form of information gathering is also utilized to assess the ability of the prospective client to start, run, and maintain a micro enterprise. In addition, it is also used to verify the amount of loans that will be necessary within the geographic and demographic context to run the particular enterprise that is proposed. Since there are often no written records to attest to these qualifications of a prospective microfinance client, information has to be gathered manually.

Information gathering is an integral part of the group-based lending system. As most new clients and group members are chosen by the groups themselves, their knowledge of the particular individual and his/her ability to be a good group member is crucial. Since the group

[40] "MSMEs." Business Economics
[41] Mukta, Joshi, "Access to Credit by Hawkers: What is Missing? Theory and Evidence from India,"

members are often from the same area, they usually already know the prospective client well. As such, they are in the best position to assess the financial needs and abilities of that person much better than an outsider such as the loan officers. Since each group member's actions affect the others in some way, it is in the interest of the group and also the MFO to have the necessary information to assess the client's financial needs and abilities. Therefore, the information-based lending system not only serves the MFO, but also the fellow group members of each client.

Such information-based lending, however, possesses the possibility of moral hazard.[42] Moral hazard is a situation in which one party may take greater risks because they are protected from facing certain consequences. Therefore, since microfinance depends upon information-based lending as opposed to collateral-based lending where clients do not face the threat of losing physical collateral, technically, microfinance clients are more likely to engage in risky financial behavior. Therefore, financially speaking, the risk of serving microfinance clients is higher. As such, the cost of serving the poor is higher as was mentioned earlier.

The information gathering and monitoring does not end at the initial stages of assessing prospective clients. Rather, the clients are monitored throughout their loan terms by the MFO loan officers visiting them frequently to enquire about their financial status.[43,44] In addition, the information-based lending system is used as a deterrent for default on loan repayments. This is done through the denial of future loans if loan repayment installments are not met regularly.[45] Since financial accessibility and reliability are core desires of the microfinance clients, this potential denial of future loans acts as an enforcement mechanism for loan repayments.

[42] Gonzalez-Vega, Claudio
[43] Joshi, Mukta
[44] Schreiner, M. and Colombet, H.
[45] Joshi, Mukta

As a financial services provider for the poor, microfinance is very much a social banking mechanism. Although it runs on market principles, certain features are modified to accommodate the target clientele. As such, the information-based lending system is a central aspect of microfinance that defines the relationship between the microfinance organization and the clients.

Intra-group Relationships

The Group Models

The practice of microfinance for the most part utilizes some sort of a group system in which clients are members of a larger group. Although various group models are used throughout the world, there are two primary group mechanisms that are practiced in India. These are the Grameen model and the self help group (SHG) model. Although other group models are used even within India, these are the two most commonly used ones.

The Grameen model refers to the model that is used by the Grameen Bank established by Mohummad Yunus in Bangladesh. This particular group mechanism is also referred to as the solidarity group model. This is because this group system enforces a joint liability mechanism. This essentially means that everyone in the particular group is liable for all the other members of the group and their repayment of their loans. Therefore, if one person in the group does not repay her loan installment in time, or defaults on her loan, then the other members of the group are liable for that amount and must pay it for her.[46]

In the Grameen group model, each group consists of approximately five members. These groups are designed with the intention of serving as social solidarity and a venue for discussion of social and economic development issues. The network of support created by the group serves

[46] Kamathi, R., Mukherji, A., and Ramanathan, S. "Ramanagaram Financial Diaries: Loan Repayments and Cash Patterns of the Urban Slums."

as a “monitoring, supervising and problem solving body.”[47] Six to eight of these five member groups together form a loan centre. Each of these groups is formed by the clients themselves as opposed to the loan officers individually identifying prospective clients. Once the group is formally recognized by the microfinance service providing organization, the group is eligible to take out loans.[48]

In the Grameen-based model in particular, a rigid set of rules is strictly adhered to. Each MFO following the Grameen model has a set of rules that the members are required to learn and memorize before they can be eligible for loans. This is done not only to foster solidarity among the group members, but to also instill a disciplinary attitude among the members. Usually at each meeting, either at the beginning or end of the session, the group members are required to recite a set of rules or guidelines that the MFO and presumably the clients believe in.[49] This type of strict disciplinary action is also reflected in the loan repayment structures.

During the initial stages of group formation, not every member is given a loan. Instead, two or three members are given a loan and then monitored in their repayment habits. Once they have successfully completed a loan cycle, additional members of the group are able to take out loans as well.[50] This particular practice is used to reiterate the joint liability system where if one member defaults her repayment, then the others must collectively do so for her. Thus, the group members are under pressure from their fellow group members to regularly and diligently repay their loans on time and form strong relationships with one another where they are willing to repay a fellow member’s loan when she is unable to do so creating a form of self insurance.

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[47] Rankin, Katharine. “Social Capital, Microfinance, and the Politics of Development.” Pg. 78 in Microfinance: Perils and Prospects

[48] Rankin, Katherine

[49] Rankin, Katherine

[50] Rankin, Katherine

The self help group model is unique to South Asia. Although this group mechanism is not used exclusively in regards to microfinance, it is the most commonly used group mechanism in the practice of microfinance in India. The self help group, much as the name suggests, is a group that is formed on the basis of a common interest in the hopes of social and/or economic development. In addition, these self help groups are for the most part comprised of all women. Many of these microfinance programs focus on serving women for three main reasons: to promote women's empowerment, to address their increased responsibilities as a mother, and to reward their higher repayment rates.[51] Initially, self help groups were formed independently of involvement in microfinance activities. Once microfinance started growing, however, many self help groups made microfinance involvement a central part of their formation and functioning.

The self help group model is often also called the village banking model.[52] This is mainly due to the fact that the self help group model is more often used in the rural areas than the urban areas. Similar to the Grameen group model, the group structure is used to provide a support network in which the women can discuss social and economic issues, join forces in the achievement of a particular goal, and can act as a venue for socioeconomic empowerment.[53]

Similar to the Grameen group model, the members of the SHG determine who can and cannot be a group member. Since all microfinance participants utilize the information-based lending system, it is the members of the community that know the other members the best. As such, the groups are self formed.

The distinctive feature of the self help group model that sets it apart from the Grameen model is the prerequisite of a savings habit. Before the members of a SHG can apply for a loan they must demonstrate that they can collectively save a certain amount at regular intervals for a

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[51] Burra, N., ed., Deshmukh-Ranadive, J., ed., and Murthy, R., ed. Micro-Credit Poverty and Empowerment.
[52] Nair, Ajai. "Sustainability of Microfinance Self Help Groups in India: Would Federating Help?"
[53] Mukta, Joshi

specified period of time. These savings are monitored and recorded by the group members themselves and are often rotated as loans among themselves. Once the group has successfully demonstrated their savings habit, they are eligible to take loans.

The most common financial intermediation program used by the SHG's is the SHG-bank linkage program that was launched in 1992. This program was started by the National Bank for Agriculture and Rural Development (NABARD), the apex bank for rural development in India.[54] Since its initiation, the program has expanded rapidly, servicing approximately 687,000 SHGS as of 2006.[55] The SHG bank linkage program is a system where the SHGs are linked to banks through the promotion of NGOs. Thus, SHGs, which are promoted by microfinance organizations, are able to access loan funds from local banks.[56] The savings mechanism is an important part of this process as it defines the ability of the SHG to take out loans as well as the amount it can take out in loans since it is a multiple of the savings amount.[57]

Promoted by the MFO, the SHG is able to receive loan funds from a local bank. These funds are loaned in bulk to the SHG, which then lends the funds to the individual group members based on their need and demands. The MFO in this particular group model serves as an intermediary and a guarantor. In addition, the MFO nurtures the SHGs by assisting the group members in maintaining their accounts and offering supplemental services that form cohesion within the group structure.[58] Therefore, the SHG as was noted earlier is an independent group formed on the basis of some commonality that then forms a relationship with an NGO, such as the MFO in order to gain financial access and reliability. Unlike the Grameen group model, the

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[54] Tankha, Ajay. "Self-help Groups as Financial Intermediaries in India: Cost of Promotion, Sustainability and Impact."
[55] NABARD Financial Report
[56] Tankha, Ajay
[57] Tankha, Ajay
[58] Mukta, Joshi

SHG group model is not defined by as many rigid rules and regulations. There are however, still certain rules and procedures the group must follow in order to remain sustainable and successful.

Cooperation and Participation:

Microfinance is very much a social banking mechanism. As such, the relationship within the client groups is very important. In particular, participation and cooperation within the client groups are crucial features in ensuring the successful delivery of financial services to the target clientele. The poor, unlike those on the higher rungs of socioeconomic ladder, do not accumulate wealth as a form of capital that can be relied upon. Instead, the poor place, by necessity, a larger emphasis on what can be called social capital. This refers to the relationships that they build and depend upon. This relationship-based social capital acts as a substitute for wealth based physical capital. Therefore, in the group based system of microfinance, cooperation and participation within the client groups are regarded as essential features to the accumulation of social capital.[59] The relationships among the fellow group members are of paramount importance as the group collectively holds the power to allow a new client to join the group or conversely to remove a member of the group if she is not complying with their expectations. Therefore, through cooperation and participation, each member builds her social capital which ensures her ability to obtain financial services consistently. The member must actively participate in taking out and repaying loans and in the savings mechanism is order to build her credibility as a creditworthy group member. In addition, she must also cooperate with her peers in order to build solidarity and sustain the group's activities.

Although this holds true across the spectrum of different group models, it is particularly true for the group models that enforce a joint liability policy. The joint or group liability implies

[59] Lahiri-Dutt, K. and Samanta, G. "Constructing Social Capital: Self Help Groups and Rural Women's Development in India."

that every member of the group is responsible for the other members' prompt repayment of loan installments. As such, this group liability mechanism creates peer pressure for the members to repay loans and therefore acts as a substitute for physical collateral.[60] This client relationship is at the core of incentives to repay loans. As such, it is the key to the client's access to credit.[61]

In addition, cooperation and participation among the group members are necessary features in being able to take out loans from the respective MFO repeatedly. Since this form of social collateral is the MFO's only security measure in the absence of physical collateral, the MFO enforces timely repayment of loan installments through the denial of future loans. Therefore, the group members do not have the option not to cooperate and participate. As Claudio Gonzalez-Vega points out, when the clients have too many options, then it becomes more difficult for the MFO to create a structure of incentives to ensure the timely repayment of loans without proper collateral.[62] Thus, a healthy group relationship based on each member actively participating and cooperating with one another is crucial in maintaining access to the microfinance services.

Microfinance places an overwhelming focus on female clients. As such, many microfinance organizations either serve only women or are comprised of a majority of female clients. As such, most of the client groups consist of only women.[63] This gender composition plays a significant role in the relationship among the group members.[64] In a male dominant society, a group that consists only of female clients encourages greater solidarity and hence more successful participation and cooperation within the group.

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[60] Mukta, Joshi
[61] Gonzalez-Vega, Claudio
[62] Gonzalez-Vega, Claudio
[63] World Bank Paper. "Impact Evaluation for Microfinance"
[64] Thomas, R. and Sinha, J. "A Critical Look at Microfinance and NGOs in Regard to Poverty Reduction for Women."

Therefore, as the available literature on microfinance suggests, relationships are central to the approach and delivery of microfinance. In particular, the literature illustrates that the two relationships being analyzed in this paper are characterized by certain features. Although the literature does not necessarily categorize these features by the relationship between the MFO and the client or the intra client group relationships, they are widely accepted features of microfinance nonetheless. Thus, in the analysis of the characteristics of these two central relationships of microfinance, in the actual practice of microfinance in India, one would expect to find certain elements.

These expectations translate into the primary argument that drives the analysis of primary question posed in this thesis. The primary argument of this paper rests on the basis that the role of relationships is central to the practice of microfinance. As a social banking mechanism, microfinance is not only based upon but sustained through the existence of successful relationships. As stated earlier, what distinguishes microfinance as a social banking system from the commercial banking system is the people-centric attitude of the approach and delivery of financial services as opposed to a profit-centric attitude. In order to serve the interests of the people, community, and society in an effort to promote economic development of those particular individuals, the ability to build and sustain relationships between and among the interested parties is crucial.

Without a positive or strong relationship between the MFO and its clients and among the fellow client members of a client group, the sustainability of the practice of microfinance is very difficult. In a social banking mechanism, much like in any social situation, when trust is broken between any two parties, they become unwilling to work with each other. Conversely, when trust is built and maintained within both parties, their willingness to enter into financial agreements with each other and honor the agreements is more feasible.

As established earlier, there are two distinct relationships in play in the practice of microfinance in India: the relationship between the microfinance service provider and the clients and the intra-group relationships within the client groups. Each of these relationships is further characterized by certain factors. Specifically, I argue that the client's desire for reliability of and accessibility to financial services and the information-based lending system utilized by the social banking system affect the strength of the relationship between the microfinance-providing organization and its clients. Similarly, I argue that the type of group model utilized by the MFO and the cooperation and participation of the client group members affect the strength of the intra-group relationships within the client groups of that particular organization.

The preceding bulk of this chapter outlined the manner in which each of these features is characteristic of one of the two primary relationships of microfinance. Although these particular features of the approach and delivery mechanisms of microfinance services were not directly linked to the two primary relationships in the literature, when grouped as such, the connection becomes evident. Similarly, I argue, that although previous literature does not discuss the varying degrees of relationship strength in both types of relationships, the field research from this project suggests that there is in fact a correlation between the stylized features of the relationships and the variations in the strength of the particular relationships.

This argument is made in the context that if these correlations are recognized, then relationships, both between the MFO and the clients and the intra client group ones, can be strengthened through adjustments of the respective identified factors. Such efforts to strengthen the relationships that are central to the practice of microfinance would contribute to increasing the effectiveness of this social banking mechanism.

Chapter 3

Section I

Methodology

Two microfinance-providing organizations from the state of Tamil Nadu were identified as case studies for this particular project for two reasons. First, microfinance has a very large and growing presence in this southern state.[65] And, second, this state was chosen due to the researcher's experiences and familiarity with the area and language. Given the limited scope of this research project, the field research consists of collaborations with two microfinance-providing organizations in Tamil Nadu. One of the organizations is SMILE Microfinance Limited. Although this organization provides services in various parts of Tamil Nadu, the client groups studied for this project are based in the city of Chennai, an urban area. The second organization is the Bullock Cart Workers Association (BWDA) Finance Limited (BFL). Similarly, although BFL also serves clients all over Tamil Nadu, the client groups studied for this project are based in the Kanyakumari district, a rural area. The comparison of the urban and rural geographic location of the clients serves as an additional variable in analyzing the factors that affect the strength of the relationships between the clients and the MFO and within the client groups.

The data collection for the project consists predominantly of interviews. These are interviews with both the microfinance-providing organizations' staff as well as with the clients of the organizations. As the client population is much larger in proportion to the organizations' staff member population, subsequently, there is a much heavier focus on the client interviews.

[65] "Over-borrowing and Competition: Are Credit Bureaus the Solution?"

Initially, the organizations assisted in identifying satisfied clients who were willing to be interviewed for the purposes of this study. Once the initial base of clients was identified for both organizations, a snowball sampling method was utilized to identify further subjects. Therefore, interviewed clients suggested other clients who could be potential interview subject. A total of twenty subjects were identified and interviewed from each organization. Although the interviews ranged from individual interviews to small group interviews, with some subjects being interviewed multiple times, each interview on average was one hour in length. All organization staff member interviews were conducted in the organization's office buildings. And all the client interviews were conducted in either the client's residence or in the nearby vicinity of her residence such as a group meeting area. In addition, several group meetings were observed in session.

While a standard questionnaire was developed and used for all interviews, the interviews were such in nature that the interviewees had much flexibility in the information they wished to share. Therefore, although certain questions were intentionally addressed, the interviewees utilized the interviews as a platform to relate their general socioeconomic conditions and their subsequent involvement with microfinance and the microfinance service provider in particular. A bulk of the interviews, especially the client interviews, were anecdotal in nature and largely a reflection of the clients' experiences.

In addition, financial records of both the organizations were also obtained and are instrumental in the analysis of the two relationships being focused upon. These financial records and numerical figures provided by the organizations comprise the majority of the quantitative data utilized in the analysis. A combination of these quantitative and qualitative data sources provides keen insight into the nature of the central relationships of microfinance and their key characteristics.

Section II

Data Analysis I

Relationship between the MFO and Clients

Financial Access and Reliability:

The relationship between the microfinance-providing organization and the clients that the organization is serving is one of crucial importance. In order for this central relationship to be sustainable and a mutually beneficial one, it must be based on addressing core needs. As such, the strength of the relationship derives from the MFO approaching and delivering financial services in a manner tailored to the target clientele's needs. Providing such tailored services as per the needs of the clients by nature serves as an incentive for the client population to maintain a healthy relationship with the MFO in order to continue receiving those services. The literature review suggests that the poor value both financial accessibility and reliability. These two features, as the literature puts it, meet in the practice of microfinance.[66]

Financial services such as loans and savings are as important, if not more important, to the poor as they are to any other socioeconomic sector of society. Without a consistent and regular flow of income and/or wealth base that serves as a safety net, the poor monitor inflows and outflows of money on a daily basis amidst facing the other consequences of poverty simultaneously.[67] The poor cannot access formal finance. And the informal financial providers, such as money lenders, are not fully reliable. Microfinance providers, as semi formal financial

[66] Basu, P. and Srivastava, P. "Scaling-Up Microfinance for India's Rural Poor."
[67] Rosenberg, Richard.

institutions provide both. As such, MFOs offer the very features that their target clientele needs and values. However, the MFO needs the clients’ cooperation in order to be a functioning and sustainable institution.

Although microfinance is a social banking mechanism, it is a financial service nonetheless. As such, microfinance-providing institutions function best when run based on market principles.[68] This means, that to nurture sustainability, the MFO must cover its costs. Serving the poor, however, results in higher costs.[69] This is due to the services that must be tailored on a micro level to a non-traditional banking clientele. The poor have no formal physical collateral they can offer. Given their circumstances and needs, they demand micro loans for short periods of time. As such, the microfinance providing institution has to handle a larger number of loans within shorter spans of time. In addition, the clients often lack access to infrastructure such as reliable transportation due to reasons raging from geographic spread to economic limitations. Therefore, in most organizations, the loan officers go to the clients as opposed to the clients going to the loan officers. Public transportation routes, especially in the rural areas cover perimeters that are far removed from the microfinance clients’ residences. As such, the loan officers and clients have to invest more time and effort into being able to interact with the clients be it at the client’s house, the group meeting areas, or the MFO base building. These factors in combination increase the transaction costs involved in providing microfinance services to the poor.

These higher costs, as have been well established but remain a point of controversy in terms of extent, are compensated through higher interest rates. As such, the poor are faced with higher interest rates and pay proportionately more in interests on their microfinance loans than

[68] Tiwari, P. and Fahad, S.M.
[69] Schreiner, M. and Colombet, H.

do clients of commercial banks. There are two types of interest rates that are used by microfinance-providing institutions, the flat interest rate and the declining interest rate. The flat interest rate refers to the interest rate that is charged every month based on the original amount of the loan. As such, the client pays the same amount in interests every month. The declining interest rate on the other hand is the interest that is charged every month according to how much of the original loan amount remains in the client's possession. This is the method that is more widely used. Of the two MFOs studied for this project, one of them used a flat interest rate and the other used a declining interest rate. S.M.I.L.E. microfinance limited uses a flat interest rate of twelve percent annually and BFL uses an eighteen percent annual declining interest rate. Although it is generally the case that the MFO borrows the money from the bank at a lower interest rate and lends to their clients at a higher rate, as BFL does by borrowing from the banks at 14.75%[70], S.M.I.L.E. microfinance does not. S.M.I.L.E. microfinance limited takes out their loans from the bank at a higher interest rate than they charge their clients. The organization claims that by repaying the loan to the bank in quarterly installments and recycling the loans in regards to the clients allows the MFO to function successfully without incurring losses.[71] However, since the MFO lends on an annual flat interest rate, if the bank loans to the MFO on a declining interest rate that is not drastically higher than the 12% the MFO charges their clients, then the success of the MFO could also thus be explained. Therefore, by charging an annual flat interest rate, even if it is lower than the commercial banks' interest rates, in essence, the amount paid in interest, or the effective interest rate is still higher.[72]

[70] Interview with BFL staff member. 7/21/09, Kanyakumari
[71] Interview with S.M.I.L.E. Microfinance Limited staff member. 7/2/09, Chennai
[72] Refer to the appendix for a quantitative explanation of the higher effective interest rate incurred from the annual flat interest rate.

However, although the interest rates are high, the poor are willing to pay those rates in order to ensure accessibility and reliability of their finances. As Stuart Rutherford points out, an aspect that is often overlooked is that the poor do not spend their days idly waiting for microfinance loans to transform their lives. On the contrary, the poor are constantly "pursuing a variety of strategies to improve their incomes…A loan is not a mark on a fresh white page- it enters an already complex household economy."[73] As such, these loans, although micro, are an integral part of a household economy that is already in motion. Therefore, the reliability of these loans is critical in maintaining a regular inflow and outflow of money. This desire for financial stability translates into the poor being willing to pay the higher interest rates if it means reliability.

This however, does not mean that the microfinance clients do not lament the high interest rates. It just means that they deal with it because they have to. Both members of BFL and S.M.I.L.E. microfinance limited mentioned during their interviews that the interest rates place an extra burden on them. Multiple members of S.M.I.L.E. microfinance limited in particular stated that repaying the principal loan amount is a manageable task, but having to pay the interest amounts makes the task much more difficult and increases the pressure they face not only from the MFO but also from their fellow group members. In the face of the increasing popularity of microfinance, one way that the MFO clients have devised to deal with the high interest rates is by taking out multiple loans from different MFOs. As the number of MFOs increases in the newfound success of the poverty reduction endeavor in a transitional economy, accessibility to microfinance is becoming easier. As such, many microfinance clients are clients of multiple microfinance service providing organizations or informal finance providers. In the face of high interest rates and irregular flow of income, many of the clients sometimes use all or a bulk of one

[73] Rutherford, Stuart. "ASA: The Biography of an NGO-Empowerment and Credit in Rural Bangladesh."

MFO loan to repay another MFO loan or its interest. A majority of the interviewed clients claimed that they borrow from multiple sources. Although they were hesitant to admit so at first, when talking about the interest rates in particular, most women said that if they did not take loans from multiple sources, then they would not be able to make complete loan repayment installments. A much larger portion of S.M.I.L.E. microfinance limited clients reported multiple borrowing behavior for this reason than did the clients of BFL. The majority of the BFL clients on the other hand reported that non enterprise related reasons drove them to engage in multiple borrowing behavior. These included shocks to the household economy such as paying for medical bills to education fees and the general need for larger loan sizes to address all financial needs within the household.

This behavior of borrowing from multiple MFOs in order to repay other MFO loans however does not necessarily negatively impact the client's relationship with the MFO. This is because, the MFOs are not interested in where the repayment money comes from, and do not inquire about it. As such, the MFOs do not necessarily know that their clients are also clients of other MFOs. As long as the client's performance is satisfactory, the MFO has no issues with the client. As the interviews with the clients indicate, the clients in fact feel a strong sense of loyalty to the MFOs as long as their accessibility and reliability remain intact. The clients, despite their various grievances of both the MFOs, related pride in their membership and particularly in the duration of their membership with the particular organization. Members of S.M.I.L.E. microfinance limited initially denied borrowing from multiple sources and stressed that they had been members of the organization for multiple years. They also stressed that they dutifully repay their loans and despite some grievances they have against the organization, S.M.I.L.E. microfinance limited has helped them improve their quality of life. It was only as the conversations continued that the members admitted to taking out multiple loans. The members of BFL also similarly stressed the positive relationship they have with the MFO. Unlike the S.M.I.L.E. members however, the BFL clients pointed to their strong relationship with their loan officers and specific BFL staff members. One member in fact said with much pride that the manager of the particular branch knew her well and understood that she was a trustworthy client even though she was currently having problems repaying on time. In the multiple borrowing scenario, it is the client who suffers the consequence of sustaining multiple accounts and possibly functioning within a debt cycle.

There are two possible reasons to explain why the field research found a larger proportion of multiple borrowing clients in S.M.I.L.E. microfinance limited, as opposed to BFL. The two explanations are the geographic location of services and the client group structure of the particular MFO. As noted earlier, the clients interviewed from S.M.I.L.E. microfinance limited are located in the urban city of Chennai, whereas the clients interviewed from BFL are located in the rural area of the Kanyakumari district. In general, in the urban setting accessibility becomes easier. This refers to accessibility of clients to reach the MFOs and vice versa. A larger number of microfinance-providing institutions are located in closer proximity in the urban setting. As such, it is easier for the clients to travel back and forth. In addition, it is also more likely that the clients will hear about other MFOs in an urban setting where the density of the population makes information travel faster and further. For the urban poor, stepping outside the house essentially means stepping into the public. As such, they are bound to interact with multiple people on a daily basis without necessarily intending to do so. This atmosphere is very conducive to enabling the informal spread of information such as the existence of other microfinance providing entities. Similarly, clients in the urban setting live in very close proximity, such as in a slum, as all the

S.M.I.L.E. microfinance clients who were interviewed did. Therefore, recruiting on the part of the MFO becomes much easier as they will be able to spread recruitment information to a larger number of potential clients in a smaller span of time and shorter amount of trips than would be possible in a rural setting where clients live in a much more spread out manner.

The second possible explanation for the larger proportion of multiple borrowings from different MFOs in S.M.I.L.E microfinance limited than in BFL is due to the client group structure. S.M.I.L.E. microfinance limited used the Grameen model, or the joint liability group structure, whereas BFL uses the self help group model without joint liability. The group liability structure adds another layer of pressure on the clients to meet their respective repayment installments. If they do not do so, they face the social and possible financial consequences that their fellow group members mandate. When living in close proximity, and having a strong communal culture, the consequences of social stigma leave an enduring mark. Conversely, consistent and timely repayment of loans by a group member builds her social capital and credibility in the eyes of her fellow group members. Thus when there is an economic shock in her household such as health problems, she can count on her group members to support her without incurring social damage. Therefore, in order to avoid such consequences and build social capital, clients become members of multiple MFOs and take out multiple loans to ensure timely repayment of others.

The relationship between the MFO and the client however, goes two ways. Although the clients are willing to pay the higher interest rates and take out multiple loans, they do so in the belief that the MFO will remain both accessible and reliable. As mentioned earlier, money management in a poor household is a daily endeavor of maintaining a very fine balance of inflows and outflows of money.[74] Therefore, when the reliability or accessibility of the microfinance services falters, the fine balance of money within the household becomes dangerously threatened. Additionally, as microfinance often encourages micro-enterprises, the smooth and successful functioning of the enterprise depends upon the reliability of the microfinance services. Often, microfinance clients utilize the micro loans to start, maintain, and expand a micro enterprise. As such, each additional loan goes directly into the enterprise in a regular and calculated timely fashion. Thus when accessibility to or reliability of the loans becomes questionable, the client's relationship with the MFO become strained.

Interviews conducted with one particular S.M.I.L.E. microfinance limited client group clearly depict this strain on the relationship. Although these clients expressed a strong bond with the MFO and pride in being long time members of the MFO, a recent lapse in reliability of timely disbursement of loans forced the clients to consider other options. The clients reported that in the past several months, the MFO was not disbursing the loans to the clients on time. When the clients approached the MFO about the issue, they were told that the funds were not being disbursed from the banks to the MFOs on time. Regardless of the bureaucratic nature of this issue or the consequences of the larger global financial crises, the ensuing lack of financial reliability for the clients brought into question their relationship with the MFO.

Given their past history of a healthy relationship with the MFO, the clients chose to accept the initial delays in loan disbursement. However, when the delays continued and unreliability increased, the clients began to have deeper concerns. Although the clients seemed reluctant to break ties with S.M.I.L.E. microfinance limited, they expressed that further delays and uncertainties in the timely acquisition of loans has forced them to start considering leaving the MFO. They related that the unreliability of timely loans was not only risking their enterprises,

[74] Rosenberg, Richard

but also affecting other economic obligations such as school fees for their children, consumption smoothing expenditures, and repayment of other loans. Such need for funds even in the short term drives them to informal forms of finance such as moneylenders who charge exorbitant interest rates. These higher interest rates only become another financial obligation which then serves to drive them deeper into the debt cycle. Therefore, the relationship between the clients and the MFO is one that is characterized at the core by the clients' desire for financial accessibility and reliability. And when these core needs are not met, the relationship either becomes strained or breaks since the client's financial obligations force her to do so.

One way in which the clients' access to the microfinance services is demonstrated is through the interaction the clients have with the loan officers. In general, the majority of the interactions between the clients and their loan officers occur during the weekly client group meetings where a loan officer is present to collect the repayments and disburse any new loans. In the case of S.M.I.L.E. microfinance limited, this quite accurately describes their relationship. Unless the clients had a specific reason to seek out a loan officer by going to the main branch building, they usually only interact with them when they came to the group meetings. As such, the relationship between the S.M.I.L.E. loan officers and clients is one that is forged based strictly on the interaction was required by the organization through the weekly group meetings. Unlike commercial banking ventures where the client must go to the banking institution, the accessibility the S.M.I.L.E. microfinance limited clients have to their financial services is increased simply thought the mandatory weekly meetings. However, given the nature of the relationship between the BFL loan officers and their clients, I argue that BFL clients enjoy greater degree of access to their financial services. The BFL loan officers have a more personal relationship with each of their clients. Unlike the S.M.I.L.E. microfinance limited loan officers, the BFL loan officers make it a point to visit each of their clients individually when possible. Therefore, in addition to interacting with the clients during the weekly group meetings, the loan officers also meet with the clients individually whenever they can. As such, the clients not only have an additional venue of access to finances through more frequent and one-on-one interaction with the loan officers, but they also have an opportunity to build a stronger relationship with the loan officers which works in their favor. By knowing the financial abilities and situations of each of their clients personally, the loan officers are able to vouch for the client's creditworthiness and subsequent access to finances.

Information-based lending:

The other key characteristic of the relationship between the MFO and their clients analyzed in this paper is the system of information-based lending. This unique feature defines a stark difference in the relationship between the financial service providing organization and its clients in the commercial banking sector and the microfinance sector. The information-based lending system, also known as the relationship-based lending system distinguishes the reason why microfinance is a social banking system.

Microfinance builds on the communal nature of the culture in India. The practice of microfinance acknowledges that one does not need to hold physical capital or stocks of wealth in order to signal one's creditworthiness. Instead, information regarding a person's creditworthiness can be gathered through interactions with her and her immediate neighbors and peers who interact with her on a daily basis and know her social and economic circumstances and capabilities. Therefore, in order to accept a new microfinance client, the MFO assesses her creditworthiness by approaching her neighbors and peers, and questioning them about her ability to be a successful microfinance client.[75]

Each MFO has its own set of rules and regulations as to how a prospective client is chosen. Although the existing clients for the most part identify new prospective group members, the MFO has the final say in the matter. The existing clients may identify a prospective new member because they need a new member to replace an old member of the group who has left the group or in order to form an entirely new group. The existing clients know what characteristics make a good and successful client and group member. In addition, they also know their community members, their financial conditions and capabilities, and can assess if they would be a good fit into the group mechanism that exits in that particular organization. Once that particular person approaches the MFO and shows interest in becoming a client, the organization then follows its regulations to asses her creditworthiness. In order to do so, a loan officer from that specific MFO will visit the client's place of residence and/or work and also her peers. In particular, the two questions that the MFO focuses on are "does the client need the full amount of the loan she specifies, especially in terms of a certain enterprise endeavor?" and "does she have the capacity to repay her loans?" Thus, the information-based lending system is in action from the very initial stages of the formation of a relationship between the client and the MFO.

The information-based lending system however lasts throughout the duration of the relationship between the client and the MFO. This is most commonly done through the loan officers' visits to the clients.[76,77] Based on the particular MFO, these visits happen sporadically, frequently, or on a weekly basis during meeting times. In both the MFOs studied for this project, S.M.I.LE. Microfinance Limited and BFL, each group meets on a weekly basis at which a loan

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[75] Mukta, Joshi,
[76] Schreiner, M. and Colombet, H.
[77] Mukta, Joshi

officer is present to collect the loan repayments and in order to disburse new loans. During this time, the loan officer has a chance to talk to all the clients and vice versa. The clients also have an opportunity to voice any questions or concerns they may have. As such, there is a regular and consistent method of interaction between the loan officers and the clients during which the loan officers can get to know their clients and their financial situations very well. Thus, if there are unforeseen shocks to the household economic situation such as healthcare problems, the loan officer is aware of the situation and can assess the client's repayment activities accordingly. Similarly, these meetings also provide the loan officer insight into the extent of success of the client's enterprise and possible use of the loan funding. As such, this information-based lending system provides a venue for the clients and the MFO to build a strong relationship with each other.

During the field research, I observed that the relationship between the loan officers and the clients seemed stronger in BFL than it did in S.M.I.L.E. microfinance limited. This discrepancy in the strength of the relationship between the loan officers and the clients can be attributed to three possible explanations. These include the gender of the loan officers and the clients, the geographic spread and culture of the MFO's servicing area, and the general purposes for which the loans are used. The gender of the loan officer is an important factor in the analysis when the gender of the client population is completely or almost completely of another gender. In S.M.I.L.E. microfinance limited all the clients are females, but all of the loan officers are males. Although the MFO has reasons for the gender makeup of the loan officer population, it is at the cost of affecting the relationship with the clients. This is an attitude that is also shared by that particular client population. One of the MFO's reasons for an all male loan officer population is that it is easier for males to use different modes of transportation quickly and efficiently in reaching the clients, in particular reference to two wheel vehicles. Given the culture in Tamil Nadu, India, it is largely frowned upon when women operate motor vehicles. Although the attitude is slowly changing, it is much more difficult to find women who drive two wheeler vehicles than it is to find men who do so. And given the location of the microfinance clients, such as the slums, it is far easier to reach the meeting places and client residences on motorcycles than it is in cars. As such, the MFO maintains that it reduces complications by seeking out only male loan officers since transportation to the clients is a crucial part of the job description. In addition, this particular MFO has all loan officers residing in official organization buildings. As such, the MFO claims that it cuts costs to have only one building housing loan officers of one gender. They state that if they were to employ female loan officers as well, then they would have to pay for the costs of maintaining another housing building since co-ed residences are out of the question given the culture. Therefore, the primary reason for an all male loan officer population is efficiency against the backdrop of culture in which it is supported.

When the clients of S.M.I.L.E. microfinance limited were questioned about the gender discrepancy between them and the loan officers however, they collectively related that having female loan officers would in fact lead them to interact with the loan officers more freely. One member said "of course we would be able to talk more freely with a lady loan officer. With men you can only talk about so much. Ladies understand each other better."[78] Given the gender discrepancy, the weekly meetings consist of the only the formal transactions that need to be completed unless particular concerns are to be voiced. In addition, given the gender discrepancy, the loan officers do not frequently visit the clients to inquire about their financial situations and hence are not as aware of her financial and household economic conditions as they could be. In a social setting where the male/female dynamics are carefully monitored, the male loan officers

[78] Interview with S.M.I.L.E. Microfinance Limited client. 7/15/09, Chennai

face additional social pressure when visiting a female client outside of mandatory group meetings which are held in neutral area with all members present. Visiting a client outside of the group meetings would require the loan officer to approach the client either at her house or workplace which pose an uncomfortable situation for both parties. In addition, female clients are less willing to discuss household issues affecting their financial lives with a male loan officer than a female loan officer. As such, the relationship between the clients and the loan officers in this case are strictly on a financial transaction basis where the information gathering on the part of the loan officers could be more limited.

In BFL however, the majority of the loan officers are women. The clients of this organization, who are also predominantly women, said that this factor is a definite contribution to strengthening their relationship with the loan officers. The clients feel more comfortable with a female loan officer and thus are more inclined to share their concerns with her. In addition, the fact that they are women, also puts the clients at ease at their group meetings where they discuss not only loan related matters but others such as domestic matters as well. One particular BFL client said in regards to her loan officer, "she knows my situation. I give my loans to my husband because I have to. Before he used to drink a lot and abuse me. But now he is not drinking anymore and is getting better and I want to help him. He is working hard, but sometimes he cannot give me the money in time, but somehow I repay it in the end. She [the loan officer] tells the manager that I will repay soon."[79] In another instance, when a loan officer was present during the interview of one of the clients, the loan officer began crying when the client started telling me about the many struggles she had faced in the past several years leading to her needing a far larger loan amount than the MFOs were willing to give her. This display of emotion from the loan officer even before the client had told me her struggles indicates that the loan officer was

[79] Interview with BFL client. 8/1/09, Kanyakumari

fully aware of the situations the client had been faced with. This situations ranged from before the client was a member of the organization indicating that the loan officer and client had spent considerable time getting to know each other. Thus the relationship between the loan officer and the client goes beyond that of just dealing with the formalities of the transactions. Rather the loan officer becomes more attuned to the client's life and is more able to put her financial situation in perspective. In addition, communicating with a female loan officer provides the clients with a sense of solidarity and support in an empowerment movement through financial stability.

Another possible explanation for the seemingly weaker relationship between the loan officers and the clients in S.M.I.L.E. microfinance limited versus BFL is the geographical spread and subsequent social culture of the area. The fact that the particular branch of S.M.I.L.E. microfinance limited that was studied was located in the urban setting could contribute to the strain in the relationship. The social atmosphere of the urban setting is faster paced than that of the rural setting. The hustle and bustle of city life leads people to budget their time carefully and go through the necessary motions of each activity effectively so that they can move on to the next. Since many of the clients of the organization in the urban setting are from slums, and slums are for the most part located in the heart of the city, the clients are engulfed in the culture of the fast paced city life. Therefore, in order to be economically active, and invest in an enterprise in a city while also dealing with the other consequences of poverty, the clients must budget their time accordingly. As such, the group meetings are one of those necessary activities that need to be completed. This combined with the close proximity of the clients' residences, makes the group meetings a concise one stop endeavor for the loan officers. Thus, group meetings in the urban setting are kept concise in the interest of effectively completing transactions in a short period of time. This therefore leads to a relationship between the clients and the loan officers that consist of only the financial obligations.

In addition, the urban setting allows for the existence of many layers of the economic spectrum. As such, those that live in the city range from the ultra poor to the ultra rich with many other socioeconomic cohorts in the middle. Therefore, there are many people who are looking for jobs and willing work in the microfinance sector. As such, the majority of the loan officers who work for S.M.I.L.E. microfinance limited come from the city but not the particular socioeconomic class or community that they are serving. As such, there is a difference in the socioeconomic statuses of the loans officers and the clients which adds an unspoken layer of differentiation between them and hence serves as a tool to maintain a certain distance between the two parties. This does not imply that the distance is consciously created. Rather, the loan officers are not from the communities that they are serving, and hence do not necessarily have as strong a relationship with the clients as someone from within the community would.

Although this does not imply that time is not of essence in the rural areas, the social atmosphere of the rural area is slower paced in nature. Although the clients in the rural area face similar obligations to their counterparts in the urban setting, their day to day duties and investment in enterprises are different. Whereas a client in the urban setting may invest in a street-side flower vending enterprise where she must create the flower garlands and then actively sell them everyday at certain times, a client in the rural setting may invest in an agricultural enterprise where she dictates her own hours but must meet a periodic deadline of supplying a seller or other intermediary with her products. Therefore, the nature of the activities that the clients in the rural areas perform is different from those in the urban areas which allow for a different attitude towards the group meetings. This combined with the physical distances between the clients' residences forces the clients in the rural areas to treat the group meetings as more than merely a venue for financial transactions. As such, the loan officer's presence at these meetings and participation in the discussions serves to strengthen the relationship between the loan officer and the clients.

Similarly, given the physical distances of the residences and meeting places and the lack of infrastructure and easily accessible transportation in the rural areas, the loan officers are forced to travel past the clients' residences and/or workplaces to get to the meeting place or travel directly to their residences in order to gather the necessary information. In fact, in walking toward the weekly group meeting area, the loan officers often stop at the clients' houses, if they are on the way, to remind them to attend if they are not already there. As such, the loan officers invest a significant amount of time in not only traveling to but also in meeting with the clients. Thus, the loan officers by necessity and design interact with the clients on an individual as well as group basis. This allows for the formation and sustenance of a strong relationship between the two parties. Therefore, the loan officers in the rural area are not only aware of the client's financial situation, but also of other aspects of her circumstances. In addition, given the nature of the rural setting, not many people from outside the community work inside it. Therefore, the majority, if not all of the loan officers in the rural setting of the MFO are from within the community themselves. As such, the loan officers are more inclined to understand their clients and form stronger relationships with them as a fellow member of the community. One particular instance that illustrates this point is a conversation with two particular loan officers in regards to a third loan officer. As we walked past a group meeting being conducted by the third loan officer, the two loan officers I was with noted that she was sitting on a chair whereas the clients were sitting on the floor. After expressing their frustration with each other, one of the loan officers explained to me that by the nature of social work, the observed loan officer should not be elevating herself by sitting on a chair while the clients were sitting on the ground. Visibly upset, she stated “she sits on the chair like she is a queen and so different from them. She is from the same community. Just because she is the loan officer she thinks she is better.”[80] Although not every loan officer feels or acts the same way in any organization, the majority of the loan officers in BFL shared the attitude of these two loan officers of being from the community and personally identifying with the clients.

Lastly, a possible explanation for the discrepancy in the apparent strength of the relationship between the loan officer and the client is the purpose for which the loan is used. A majority of the loans taken by the clients in S.M.I.L.E. microfinance limited was/is used for micro-enterprise purposes. On the other hand, the majority of the loans taken by the clients BFL were/are used for consumption smoothing purposes or for enterprise investments that were/are not directly those of the loan recipient.

Clients who use the microfinance loans largely for financial investments in a micro-enterprise, view their relationship with the MFO as one that is strictly financial in nature. This attitude works both ways. This means that the MFO or the loan officers are also aware of how the clients utilize their loans. Thus if the loan officers know that the client is using the loans primarily for investment in her own micro-enterprise, then the loan officer also views the relationship as one that is strictly financial in nature. S.M.I.L.E. microfinance limited loan officers and staff members were very particular in specifying that their clients for the most part, use their loans only for enterprise related expenses.[81] Therefore, the loan officers’ assessment of the clients’ needs were based solely upon how much is necessary for the particular enterprise and

[80] Conversation with BFL staff members. 7/22/09, Kanyakumari
[81] This claim must be understood in the context of an illusion created by both parties considering that there is a lack of separation between the household and firm in regards to the poor.

how successful that enterprise can be in the given location. As such, neither party expects the relationship to be any deeper and does not actively try to do so.

Conversely, the clients who use the majority of their microfinance loans for consumption smoothing purposes or investment in other family members' enterprises seem to have a stronger relationship with the loan officers. Similar to the previous case, the loan officers in this case are also aware that the clients are using their loans for a wider array of purposes than strictly investment in her micro-enterprise. This knowledge of how the loans are used and encouragement of such uses through renewed disbursement of loans implies that the MFO is aware of differing needs for microfinance funding and is willing to service them. Such funding of non entrepreneurial behavior implies a higher risk on the part of the MFO. Therefore, it consequently also implies that there is more information gathering being done by the MFO through the loan officers. In order for the loan officers to gather satisfactory information that mandates continued disbursement of loans to clients and their successful repayment of those loans indicates that there is a strong relationship between the client and the loan officer that allows for such information-based lending.

Data Analysis II

Intra Group Relationships with Client Groups

The Group Models

The second central relationship in the practice of microfinance is the relationship among the members of the client group. Since microfinance is based on the group structure, as opposed to the individual structure that is most commonly practiced in commercial banking mechanisms, the relationship among the group is of crucial importance in the individual group members' access to the financial services offered by microfinance organizations. As such, one of the key characteristics that influences the intra-group relationships is the particular group model that is utilized. As the literature review indicated, there are two primary group models used in India, the joint liability group model, also known as the Grameen model, and the self help group model.

The Grameen group model is named for the group structure most notable used by the Grameen Bank of Bangladesh that is now widely used all over the world. In this model, each member of the group is liable for every other group member's loan repayment commitment.[82] As such, her relationship with the group is extremely important in a two fold manner. Firstly, if she must be liable for her peers, then she must have a certain amount of trust in them that they will regularly and fully repay their loan installments, or at the least make every attempt to do so. In addition, she must have a strong enough relationship with her group members which would facilitate her willingness to help pay a fellow group member's repayment installment in the case that an unexpected shock deters that particular woman's ability to do so. On the other hand, every group member's relationship with her fellow members is important because she must earn their trust as a reliable client to remain an active member of the group and a client of the MFO. In addition, she must also have a strong enough relationship with her fellow members so that in the case that she is unable to pay an installment on time, her peers will do so for her without the threat of drastic social and economic consequences.

In general, members of a joint liability group are women who live in close proximity with each other. As such, they have a well established relationship even before they become clients of a MFO. In addition, since the groups are largely formed by the group members themselves, they are careful to include only those whom they collectively believe will be a good microfinance client and group member. Also, since these women are often, if not always, from the same

[82] Kamathi, R., Mukherji, A., and Ramanathan, S.

communities, they are aware of each others financial conditions, family situations, and overall personal characters. The sense of solidarity that they share from being in similar economic situations provides them with not only sympathy for each others financial constraints but also the ability to gauge each others financial capabilities.

The field research for this project involved the case study of one organization, S.M.I.L.E. Microfinance Limited that utilized the joint liability group model. In urban settings in general, there is a concentration of the poor population in slum areas. Subsequently, the majority of the client groups of this organization consisted of women from the slums. A slum by nature and necessity is a densely populated area with all the residents living in very close proximity with each other. As such, the people within a given area of the slum know each other quite well and are aware of each others domestic, economic, and personal situations. The majority of the women who are in client groups for this organization therefore knew each other prior to becoming clients and already had well established relationships with each other. Their relationships therefore are not based solely on their client group status, but rather on much more than that involving their families, friends, and everyday life in general.

The observed relationships among the various group members and within the groups as a whole in S.M.I.L.E. microfinance limited client groups remained consistently strong. Although the clients were not questioned specifically about the strength of their relationship within the particular group model, certain conclusions can be drawn from their various responses. For example, every client's immediate response upon being questioned about the loan repayment defaults within the group was to say that there has never been any issue with defaults within their particular group. Although this is not necessarily true, it does however indicate a strong sense of solidarity within the groups. The groups in a sense become a family unit of sorts. Not only does each of the members have an equal responsibility for themselves, but they all also have an equal responsibility for each other. As such, it becomes logical that they act in the interest of the group as a whole. Such an instinct to protect each others reputation and the reputation of the group as a whole illustrates that the relationship within the group functions on multiple layers.

In 2008, S.M.I.L.E. Microfinance Limited reported a write of ratio (default rate) of 0.00% and BFL reported a write of ratio of 0.08%.[83] Although there may be one client within the group who defaults on her loan repayment for a specific week, the MFO is not necessarily privy to this information. As long as all the loan repayment installments are consistently made, regardless of who exactly provides the money, the group as a whole does not face the threat of potentially losing access to future funding from the MFO. As such, it is in the group's interest to maintain a clean record in terms of loan repayments.

This pressure to make complete repayments for every member of the group using the joint liability method however translates to peer pressure on all members of the group from fellow members be it physically apparent or not. Therefore, one way in which the group members deal with the situation is by taking out multiple loans from multiple sources including moneylenders. Although every S.M.I.L.E. client interviewed said that there were no problems with loan repayment defaults in her group, the majority of the women also said that they were either at some point or currently engaged in multiple borrowings of funds from various sources. One woman said "I have no choice. I can repay the loan amounts with the money I make by vending the flowers. But I have to borrow from someone else (moneylender, family member, or other financing organization) to pay the interest rates."[84] Another woman, as she was getting her eight year old son ready for tuition, after school study session, echoed her group member by

[83] Mix Market Website
[84] Interview with S.M.I.L.E. Microfinance Limited Client. 7/3/09, Chennai

saying “My children’s education is very important. How else will I pay for his school fees and pay the interest?”[85] Although none of the interviewees directly or specifically mentioned group pressure to repay the complete loan amount and interest rate promptly, their stories made it evident that they would do what was necessary to make the repayments in time so that the group as a whole would not face the consequence of being denied future loans. This indirectly implies their desire to maintain healthy relationships with their fellow group members because defaulting on a repayment affects the entire group and not just the particular individual.

Every S.M.I.L.E. client who was interviewed was currently involved in running some type of a small scale enterprise. These enterprises ranged from making and selling flower garlands directly to customers as street vendors to sewing and selling bulk orders of clothing to merchants. Therefore, the majority of the loans taken from the MFO were used toward financing their enterprises. This however does not mean that the loans were never used for consumption smoothing purposes. Although they were used to finance health treatments, in house renovations, paying school fees, and family emergencies among other needs, the loans were primarily used for the enterprise that the client was personally involved in. As such, the group members knew to a certain extent that they could rely upon their fellow group members to promptly repay their loan repayments as long as their businesses were running smoothly. Since all the clients interviewed live and work in such close proximity with each other, they all have a fairly good idea of the status of each other’s businesses. As such, it seems that members of the group have a level of confidence in being liable for each others loan repayments because for the most part they know how the fellow group members are investing their loan funds.

In addition, several of the groups interviewed from the same area in the slum talked about how they used part of their loans for community purposes. For example, several of the

[85] Interview with S.M.I.L.E. Microfinance Limited Client. 7/6/09, Chennai

groups took great pride in having financed the installment of electric lines in their stretch of the slum so that they could have electric lights inside their homes. Each group member contributed a certain portion of her finances toward the project and therefore jointly financed the electric lines. By investing in a project that was beneficial to the entire community, each of the members had an incentive to get involved. Although this was more of a consumption smoothing expense as opposed to a revenue generating investment, working collectively strengthens the intra-group relationship. Although the geographical proximity of the clients' residences is a definite factor in the decision to take collective financial action for the benefit of the community, the joint liability group model also plays into it. In the joint liability group model, the group members have an incentive to keep track of how their fellow members utilize their loans[86], and as such, joint community ventures are a favorable investment.

A bad relationship among group members not only means a bad financial relationship due to their memberships in a financially motivated organization, but also means a negative community relationship. Since the majority of the group members are from the same communities and live in close proximity with each other, their membership in the MFO client group is an extension of their daily lives. As such, their group relationships and community relationships are not mutually exclusive. As such, a strong community relationship translates into a strong intra client group relationship and vice versa. This characteristic of the intra-group relationships is particularly evident in the existing group members' relationships with women who have left the group and the MFO for various reasons.

One would logically assume that if a group member leaves the group, more than likely it is a situation where there are harsh feelings toward her since the group at some point faced the extra burden of finding a new group member to replace her. The interviews, especially of the

[86] Rankin, Katherine

S.M.I.L.E. clients indicated otherwise. When talking about two women who had recently left two separate clients groups, the existing members were surprisingly supportive of both their decisions. In one woman's case, she left because the she was not receiving the demanded loans within her desired timeframe. When talking about this particular person, her fellow former group members focused their criticism on the MFO and not her. They collectively criticized the MFO's recent delays in disbursing the loans on time and even supported this particular woman's decision to leave the group and organization. One of her fellow former group members said "It is very difficult for her to maintain her business if the organization does not give her the loan on time. Her husband gets angry. So she had to leave and find another organization." The other woman who recently left one of the groups did so because her husband did not want her to be involved with financial matters. Her fellow former group members also spoke of her in a very supporting and sympathizing manner. They acknowledged that she had a responsibility to her family and had to do as her husband wished. In fact, in a follow up interview, this particular woman was present at the house of one of her former group members and was helping her children get ready for school and pitched in on the interview regarding the MFO. Therefore, the strong intra-group relationship of these client groups were not based solely on their function as a financially based group, rather it is based on a bond forged through their membership within a broader community.

The other primary group model used in the practice of microfinance in India is the self help group model. These groups are generally larger than the groups used in the joint liability model with around fifteen to twenty members in each group. Unlike the Grameen group model, these members in the self help groups are generally not jointly liable for the loan repayment commitments of every other member in the group. The distinguishing feature of the self help groups is that each member in the group has to establish a consistent savings habit before the group as a whole can apply for loans through the microfinance-providing organization. This not only indicates that the group members are proving their creditworthiness to the microfinance providing institution, but also indicates that they are committing to be financially responsible in order to maintain a successful group relationship with their fellow group members.

During the field research for this study, one organization, BFL, that uses the self help group model, was studied. The intra-group relationships observed within the client groups of BFL did not indicate a consistent nature of the strength of the relationships. Although the groups functioned successfully, the clients did not convey as strong a sense of solidarity among the group as the joint liability group clients from S.M.I.L.E. microfinance limited did. In discussing their financial situations, the client group members rarely referred to the group structure as a whole, and if they did, it was more often than not in a negative manner. This does not mean that the group members viewed the group structure in a negative light; rather, the group structure is such that, in terms of the microfinance services, there is a heavier emphasis on the individual's needs and abilities as opposed to that of the group's as a whole. The group for the most part is viewed merely as a mechanism to facilitate the clients' access to financial services.

One possible explanation for the lack of strong intra-group relationships among the observed self help groups could be the geographical spread of the clients' residences. In the rural setting, poverty does not lead to cluster housing as it often does in the urban setting. Rather, in the rural areas, poverty is reflected in the physically smaller size of the dwelling place that is often rented property. As such, these clients located in the rural area, have residences that are set much further apart than those of the joint liability group members in the urban slums. Although there is not a direct correlation between the type of group model utilized by the MFO and the geographical location of the clients, there does seem to be a correlation between the geographical spread of the clients and the strength of the intra-group relationships that are fostered. Since the group members live relatively far apart from each other, they do not necessarily interact with each other on a daily basis. In general, the interviewed group members stated that they only interact with each other either during their respective group meetings or when they specifically seek to interact with a fellow group member outside of mandatory group activities.

In the rural setting, where the BFL clients were located, the individuals have more control over their privacy. Therefore, unlike the densely populated urban slum setting where outside the home structure literally means in public, in the rural setting, the homes are not only generally larger structures, but there is generally some amount of what can be termed "private" space separating one person's residence from the next. As such, even daily chores that need to be done outside the home structure can be done in relative privacy without inevitable contact with fellow self help group members. Additionally, since self help groups are often formed on some commonality that isn't necessarily dictated by their immediate residential surroundings, it is not necessarily the case that the members of a group are immediate neighbors.

The clients of BFL who were observed incur a higher cost in attending the group meetings than the clients of S.M.I.L.E. who were observed. This is also due to the geographic spread of the residences. Since the members' homes are located further apart, they have to travel a further distance to attend the weekly group meetings. As such, the opportunity cost of attending the meetings is a larger span of time during which numerous other chores can be performed. Since the structure of the self help group is such that the loan repayment is an individual responsibility as opposed to a group responsibility, attending group meetings promptly and regularly every single week is relatively less crucial to the client groups' ability to function successfully. Although the group meetings are mandatory and necessary for the collection and distribution of loans and savings, as long as the loans are repaid in full within a certain time frame, the groups remain viable clients of the MFO. As such, it was observed that it was more common for members of the BFL client groups to miss weekly meetings than was the case in the S.M.I.L.E. microfinance limited client groups.

This was reflected in two separate instances. In the first instance, when I approached a specified location to observe a group meeting, I was informed that the group was not meeting at the pre arranged time because one woman still had not returned from buying groceries, another was picking up her children from school, and a third had gone to visit relatives in a neighboring village. Although this was only one meeting, the nature of the activities that prevented the group from meeting and the nonchalance with which the news was conveyed indicates that the prompt and regular group meetings were not of paramount importance. In the second instance, only half of the self help group members were present at the meeting. In addition, the members who were present proceeded to complain about the member who was designated as the group leader saying that she either very rarely came to the meetings or did not come on time. The agreed upon solution, which is entirely in the group's control, was to appoint another leader and still keep the individual in question as a member of the group. Since that particular member's lack of regular involvement did not directly affect the group's overall viability, they did not even consider removing her from the group as a joint liability group would have. Therefore, the intra-group relationships observed in the self help groups in these regards indicated that they were relatively weak in nature.

On the other hand, there are certain activities that are communal in nature that lend to building the relationship among group members if in fact their residences are located in the same vicinity. One example of this is washing clothes in the nearby lake. Although the group members do not plan to do their chores during a pre arranged time, inevitably they cross paths with fellow group members while doing so. While going to one of the interview sessions, we passed by several members of a self help group doing laundry at the lake. Although this was not an activity involving only members of the group, it was a community building factor nonetheless. Getting together in an informal setting like this allows for group members to discuss and exchange information that impacts their relationship, but does not necessarily arise during group meetings. Although these informal gatherings do not often involve all members of a particular self help group, information spreads quickly within the community.

Another factor that contributes to the relatively weak nature of the intra-group relationships is the use of the microfinance loans by the clients. The majority of the BFL clients interviewed indicated that they used the loans for purposes other than financing their own small scale enterprises. One woman said she gives the majority of her loans to her husband. She essentially acts as the intermediary between her husband and the MFO. Although the BFL lends its financial services to both men and women, this particular client's husband finds it more convenient for his wife to take the loans out in her name so that he does not have to fulfill the obligations of an active self help group member.[87] Another woman said that recently she has been using part of her loans to repay build up debts to third parties, part of it to finance her son's education, and another part of it to pay for her husband's operation cost. During better times however, she uses the loans to finance the hay transportation business that her husband and son jointly run.[88] A third woman did not specify how exactly she uses her loans but made clear during our conversation that she does not work. She also mentioned that two of her sons were in

[87] Interview with BFL client. 8/1/09, Kanyakumari
[88] Interview with BFL client. 8/12/09, Kanyakumari

military school at the time of the interview and her daughter had just graduated from college.[89] These examples illustrate how the loans are used for purposes other than self run small scale income generating enterprises. When the loans are used for purposes such as these, the fellow group members are forced into a state of greater uncertainty as to the promptness of the loan repayment installments.

This combined with the structure of the self help group system factors into the weaker intra-group relationships observed in the BFL client groups. In the self help group structure, the complete loan repayment is more important than the individual loan repayment installments. Therefore, unlike the joint liability group structure of S.M.I.L.E. microfinance limited in which the group members have an incentive to build strong relationships with their fellow group members and ensure that they make every effort to repay every installment on time, the self help group member of BFL do not. As long as the entire loan is repaid within the specified time frame, the group is eligible to take out another loan. Therefore, although the access to future loans acts as an incentive, without joint liability, the group members do not have as strong an incentive to build strong relationships with their group members and act as a constant source of support and pressure. This however does not imply that these group members do not have strong community relationships with each other. The members of a self help groups do have strong relationships with each other which are far more social in nature without their individual relationships with the MFO playing as significant a role in them.

It is important to note that the savings mechanism utilized by these groups also plays a role in the nature of the intra-group relationships. Unlike in the S.M.I.L.E. microfinance limited client groups, the loans generated from the savings mechanism are given more importance than the loans taken from the MFO. In fact, each of the client groups has 6 ledgers to keep track of the

[89] Interview with BFL client. 8/12/09, Kanyakumari

loans generated from the savings, whereas they only have one ledger to keep track of the loan taken from the MFO. Although the material used to keep track of the savings mechanism is more intricate, there is less pressure involved in the practice of it because the MFO is not directly involved. Therefore it is completely run by the group members, with occasional bookkeeping assistance from the MFO staff members. As such there is far less pressure on the group members to work within certain constraints. This lack of pressure allows for the members to have relationships with each other that are more socially guided and devoid of direct pressures from an institutional structure.

Cooperation and participation

The group mechanism utilized by the microfinance-providing institutions serves as a build in system for asset accumulation. Assets, in the practice of microfinance, as has been pointed out, refer to social capital. It is in the client's interest to accumulate positive social capital that not only indicates her credit worthiness but also influences her ability to remain an active member of the client group.[90] In order to do so, the group members must have strong relationships with each other in which they trust and support each other. For the group to remain a viable and successful client group, each member must hold the others in high enough esteem that she supports her fellow group members' access to finances in the belief that they will promptly and continuously repay each loan installment. The group members collectively hold the power to decide if they want to invite a certain individual to join their group because they think she would be a good client and group member or conversely to remove a certain individual from their group because she is not cooperating with the set procedures. As such, participation and cooperation of each member in the group activities are essential aspects of accumulating social

[90] Lahiri-Dutt, K. and Samanta, G.

capital and therefore assets that influence her access to the microfinance services of the organization that the group is a collective client of.

Given the group based nature of the microfinance system, participation of each member in the group activities is crucial. The group meetings, which occur on a weekly basis in both the organizations observed in this study, are more than just a space for the group members to meet socially. Since it is the time during which the clients repay their loan installments and also make requests for new loans, it is crucial that each of the members is present. If a group member does not attend these weekly meetings repeatedly, she not only jeopardizes her accumulation of social capital, and therefore access to finances, but also the entire group's access to future loans depending upon the rigidity of the particular microfinance providing institution.

While interviewing a client group of BFL that had recently disintegrated, I learned that the reason for falling apart was not voluntary, but rather necessary because of the lack of participation and cooperation among the group members. In particular, it was the lack of cooperation and participation of two group members that led to the disintegration of the entire group. Without communicating with their fellow group members, two of the members of the group moved out of the state without repaying the loans that they had taken out. Although they had both been regularly active members of the group prior to their sudden move, the disruption caused by their lack of participation and cooperation in the group activities led to the disintegration of the entire group in terms of being able to interact with the MFO.

As stated earlier, BFL uses the self help group model. Therefore, the group members affiliated with this organization are not liable for each others loan repayment installments. Yet, it is crucial that they have a strong relationship with each other since the loans are given on behalf of the entire group collectively. All self help groups are formed around some common factor that ties the group members together. This can range from the particular enterprise that all the group members invest in to the geographical proximity of where they live. This particular self help group was formed around the commonality of religion. Therefore, each of the members of the group was Muslim, with multiple women in the same group who were from the same family. Since Islam is one of the minority religions of that particular area, the women shared a sense of solidarity that went beyond the financial aspect of the group.

When the two members suddenly and unexpectedly left the group, the structure of the group in terms of taking out loans from the microfinance institution collapsed. Although the remaining members of the group were able to complete that particular loan cycle, they were not able to start another one because they did not have the necessary number of members. Therefore, the lack of cooperation and participation from just one or two members of the group affects the financial situations of all the members of the group. Two of the remaining members from this group specifically lamented about the increased difficulty they were facing in paying their rent. Although these women are located in the rural setting, because of their limited income, they are unable to own land and property. Therefore, the majority of the microfinance clients interviewed for this study, in the rural setting, live in rented houses and face the additional expense of making those monthly payments in addition to other enterprise and consumption smoothing expenses.

Although it is possible to re-form into a new group and resume interacting with the microfinance providing institution, it takes time to do so. The existing members of the group have to ether actively seek out new candidates who fit the qualifications to become new members of the group or wait until they are approached by potential candidates who have heard about this particular self help group and are interested in becoming an active member. This process itself involves cooperation and participation from the remaining members of the group.

They have to collectively assess the creditworthiness of the new candidate(s) and collectively agree to resume a relationship with the MFO and begin taking out loans. Since these remaining group members have experienced a relatively sudden disruption in their intra-group relationships and to their access to finances, there is an understandable strain on their relationships with each other. As such, it takes time to rebuild a network of trust not only among themselves but also with the new group members replacing the old ones.

The intra-group relationships observed in the self help group model rests on several different layers of functioning. Therefore, the cooperation and participation of the group members is necessary for multiple purposes. One aspect of the group activities that distinguishes the self help group model from the Grameen model is the structure of the savings mechanism. As was established earlier, a defining factor of the self help group model is that the client group must establish a regular savings habit for a specified amount of time prior to being able to take out loans through the microfinance providing institution. This savings habit does not stop at the point when they start interacting with the MFO. Instead, the client groups continue the savings habit and use it as another method of financing.

The type of financing is a form of the rotating savings and credit associations (ROSCAS) that are widely used as a primary source of financing by the poor around the globe. For the client groups of BFL however, this is an additional source of financing. Unlike many other microfinance-providing institutions, BFL does not collect the savings from their clients. However, savings is a mandatory component of the client groups functioning. Therefore, BFL acts as a facilitator for the client groups to run a rotating savings and credit association of their own. The organization provides the client groups with record keeping materials and assist them in recording the inflows and outflows of the cash, but do not actually collect anything other than the loan repayment installments.

The group members collectively decide how much they will save every week. These savings are set aside into a separate fund. When this fund reaches an agreed upon amount, it is then given as a loan to one of the group members. This system is repeated again and again by loaning out the funds to a different group member for each cycle. Therefore, the savings are kept within the group and are rotated as loans among the members. Since this savings mechanism does not necessarily involve interaction with the MFO, except for the use of the record keeping ledgers provided by BFL in this case, it is a form of financing the groups can utilize without actively taking loans from the microfinance providing institution. However, in order for this financing mechanism to work successfully, it needs the cooperation and participation of the group members. The intra-group relationship, especially in the self help group model is of crucial importance regardless of the group's involvement with a microfinance providing institution. Therefore, even if the group is unable to take out loans from the MFO because two of the group members suddenly left the state and the group no longer fulfills the group requirements of the MFO, the members can still engage in running a rotating savings and credit association. As long as the remaining group members are willing to participate and cooperate with each other, they can mobilize this savings mechanism into an informal primary financing mechanism. Having this secondary financing mechanism helps the group considerably in dealing with unexpected shocks to their financial interaction with the MFO. Although I do not know if this particular self help group engaged in this behavior after losing two of it's original member, it is theoretically highly likely and plausible.

Unlike BFL, S.M.I.L.E microfinance limited utilizes a savings structure where the MFO collects the savings of the clients on a weekly basis. These savings therefore accumulate much like they would in a commercial bank. However, the clients cannot access these funds until they reach a certain amount and are restricted in how much they are able to withdraw at once. This method of savings is another reason why S.M.I.L.E. Microfinance Limited clients feel a heavier burden from the interest rates. This savings mechanism increases the effective interest rate because the clients are essentially paying an annual flat interest rate on an even smaller loan balance since part of the loan is required to be put into savings. Therefore, the S.M.I.L.E. microfinance limited clients do not necessarily have that second layer of financing available unless they facilitate a separate rotating savings and credit association or something similar on their own, which none of the clients interviewed for this study claimed to do. This coupled with the joint liability structure of the group mechanism they use makes the participation and cooperation of every single group member even more crucial to the smooth and successful operation of the financial system. If each group member does not cooperate and participate consistently by showing up to weekly meetings and contributing her share of the loan repayment installment, then she puts an additional burden on the rest of the group members. This therefore leads to a strain in the intra-group relationship. Conversely however, participation and cooperation also means understanding that there will be times when a group member defaults on her repayments due to unforeseen shocks to her finances and being willing to repay for fellow group members during that time in order to keep the group as a whole a functioning entity.

Cooperation and participation are important aspects of the intra-group relationship not only because they promote a positive relationship between the client group and the microfinance providing institution, but also because they allow for the group to work collectively in their interest. By cooperating to participate in weekly meetings, the group members are able to create a space where they build trust in each other and share a sense of solidarity. As such, the meetings become a venue to share their concerns with each other and formulate ways to address them.

Sometimes, depending upon the nature of the issue at hand, the strength of the intra-group relationships fostered by participation and cooperation of the members serves to negatively impact their relationship with the microfinance providing institution. By voicing their concerns and sharing them with each other, the group members sometimes find that the group structure serves as a support network that offers collective solutions. One of the S.M.I.L.E. microfinance limited client groups clearly illustrates this point. Although the relationship between the clients and the MFO had been relatively healthy for a number of years, the MFO was recently facing some problems in their loan distribution timeline. Although the organization had been consistent and prompt with disbursing loans to the clients on time in the past, during the time of the field research and the several months leading up to it, the MFO was delaying disbursing the loans to the clients by up to a month. When the clients approached the MFO regarding the lapse in prompt loan disbursement time, the MFO claimed that it was the banks that were at the root of the problem. That the banks were not providing the funds to the MFO in time which therefore translated to the MFO being unable to disburse the loans to the clients on time.

As noted earlier, the poor have a tight window of flexibility in terms of their finance. Their inflows and outflows of cash are carefully calculated and monitored on a day to day basis to ensure the fulfillment of basic necessitates.[91,92] Therefore, a delay in receiving a loan that was expected within a certain time frame jeopardizes the fine balance of the allocation of both

[91] Rosenberg, Richard
[92] Collins, D., Morduch, J., Rutherford, S., and Ruthven, O.

household and enterprise funds. Forced to live within a tight budget, many of the microfinance clients cannot afford to wait for uncertain spans of time to receive loans that have already been factored into the calculations of how the household funds will be used.

As such, the S.M.I.L.E. microfinance limited clients were understandably concerned about their financial situations. During the interviews, the members of one group in particular mentioned that they were having ongoing discussions within the group for collective action. As relatively long time clients of the MFO, the group members were reluctant to abruptly sever ties with the organization. However, as the delays occurred repeatedly, the members started discussing alternate plans of action to safeguard their financial interest. The strong intra-group relationship these group members had with each other allowed them to discuss with each other that went beyond the necessity of routine group tasks. The members of this group in particular mentioned that they have been collectively considering the option of leaving S.M.I.L.E. microfinance limited and joining another MFO that they had heard about. Through consistent participation in the group activities and cooperation with each other, the members of this group had formed a strong enough intra-group relationship that they were able to consider collectively leaving one organization and joining another.

Being able to make such a decision collectively would greatly benefit the group. This is because it would make both leaving the MFO and joining another one much easier. If only some members leave the MFO and the others stay, it would place a burden on the remaining group members because they would then be faced with the challenge of finding new group members to replace the old ones in order to be able to take out loans in the future. Similarly, the previous members of the group who try to join a different MFO face the challenge of proving their credit worthiness to either existing groups of the new MFO that are looking for new members or to organizationally unaffiliated women looking to form a new group in order to become clients of the MFO. Therefore, if the group does not act collectively, both the members who remain with S.M.I.L.E. microfinance limited and the ones who leave will face challenges in forming viable client groups. If this particular group decides to leave and join another MFO, by having a strong enough relationship among themselves to act as a group as a whole, the group members will not only be acting in their interest of addressing the issue of the delay in loan disbursement, but also in saving themselves the trouble of going through the process of forming new intra-group relationships.

In addition, the group's decision to discuss leaving the organization collectively speaks to the strength of their intra-group relationship especially because of the joint liability nature of the group model that this MFO utilizes. The joint liability model dictates that if one member of the group defaults on her loan repayment, then the others in the group must repay that amount for her. Therefore, if one or multiple members of the group decide to leave the organization because their demand for new loans were not being processed promptly and in the process left current loan repayments unpaid, then their fellow group members would have to take on the burden of repaying them. Although multiple variables often play into a person's decision to leave an organization and client group, doing so in a joint liability group model setting to a certain extent indicates that the individual is not overly concerned about the burden placed on the fellow group members since each member is fully aware of the mandates of the joint liability structure. Therefore, deciding to tackle the issue collectively illustrates a level of participation and cooperation within the group that indicates an intra-group relationship based on a sense of solidarity and support for each other.

Chapter 4

Conclusion

The purpose of this study is not in any way, shape, or form, to discredit the approach and delivery mechanisms utilized by either of the two organizations analyzed. These two organizations are used primarily to highlight the multiple variables in the approach and delivery mechanisms that each of them chose to use while serving the target population of Tamil Nadu microfinance clients. As such, S.M.I.L.E. Microfinance Limited and BFL are juxtaposed in this study for the purpose of comparison. With each organization illustrating a different type of the same variable, such as the type of group model used or the type of geographical location of the client population served, the distinctions in the variations of the strength of the relationship are more visible.

Chapter 3 illustrates that the four features identified in the literature review section of this paper do in fact affect the variations in the strength of the two primary relationships. Simultaneously, the analysis in Chapter 3 also indicates that the answer to the primary question posed at the beginning of this paper is not simply one of the two organizations. In attempting to figure out which organization has stronger relationships, the analysis section illustrates that the factors that define the four stylized features of the two primary relationships directly contribute to the strength of the relationships between the MFO and clients and the intra client group relationships. As such, the method utilized to decipher the answer to the primary question of the study served as a tool to validate the primary argument set forth.

The analysis of the field research data leads to the conclusion that neither one of the organizations boasts having stronger relationships in its practice of microfinance than the other.

Rather, the analysis illustrates that BFL portrays a stronger relationship between the organization and its clients than does S.M.I.L.E. Microfinance Limited. And that conversely, S.M.I.L.E. Microfinance Limited portrays stronger intra client group relationships than does BFL. As such, it is important to note that the analysis does not conclude that either of the organizations has a negative relationship in regards to either relationship, rather, that each of the organizations has a relatively stronger primary relationship than the other.

BFL portrays a relatively stronger relationship between the MFO and the clients in terms of accessibility and reliability to and of financial services through a lower reported instance of multiple borrowing behavior and more personal relationships with their loan officers. Conversely, S.M.I.L.E. Microfinance Limited has a weaker relationship between the MFO and clients due to more frequent multiple borrowing behavior in the face of high interest rates, lack of reliability in disbursement of loans, and less personal relationships with their loan officers due to the all male gender composition of the loan officers in relation to the all female client population. This higher instance of multiple borrowing behavior can be attributed to two possible reasons: the fact that the target clients are in the urban setting, in terms of accessibility to multiple financing sources and to the fact that they were members of a joint liability group model.

In addition, BFL also portrays a relatively stronger relationship between the MFO and clients in terms of the information-based lending system due to three primary reasons. These include: the more personal relationship between the clients and loan officers, the socio economic culture and implication of physically further distances between areas of the rural setting, and the largely non enterprise related purposes for which the microfinance loans are taken.

On the other hand, S.M.I.L.E. Microfinance Limited portrays relatively stronger intra-group relationships within its client groups than does BFL. In particular, S.M.I.L.E.

Microfinance Limited portrays a stronger intra-group relationship in terms of the type of group model used due to the densely populated urban setting of the client groups, the inherent incentives associated with the joint liability structure of the group model, and the enterprise related purposes for which the loans are used. In addition, it is worth noting that the intra-group relationship in terms of the group model was weaker in BFL potentially due to the savings mechanism associated with the self help group that allows for an extra layer of safety net finances.

In addition, S.M.I.L.E. Microfinance Limited also portrays relatively stronger intra client group relationships in regards to the cooperation and participation of the group members. One reason for the stronger relationship is the incentive to maintain the group given the nature of the savings mechanism in the joint liability group structure that does not offer a safety net of financial resources. The other reason is the sense of solidarity that is build through close proximity and similar financial experiences.

Therefore, each organization has a strength in one of the two relationships. As such, it can be concluded that microfinance organizations do not necessarily enjoy equally strong relationships between the MFO and its clients and within the client group members. Although a definite statement cannot be made based on only these examples, it can be inferred that it is plausible that more often than not, a microfinance-providing organization will have one primary relationship that is stronger than the other. Thus, the lack in the strength of the relationship between the MFO and its clients can be fostered in the intra client group relationship and vice versa.

In addition, it can be concluded that there are a wide variety of factors that influence the strength of either of the primary relationships. These factors include, but are not limited to:

geographical setting of the client population, type of group model, how the loan is invested, the gender of the loan officers in relation to the client population, and interest rates.

It is important to note the limitations of this study. Given the small scale nature of this project, there are many variables that are not accounted for. The conclusions drawn of the organizations as a whole are a projection of case studies within each organization. As the first chapter indicated, both organizations have multiple branches operating throughout the state of Tamil Nadu. The clients and staff members interviewed for this study were from one branch of each organization, therefore consisting of a microcosm of the larger organizations. In addition, it is important to note, that for the purposes of this study, each of the variables analyzed was analyzed as a complete and separate variable that stood on its own. In reality, each microfinance-providing organization is compilation of factors and variables that are not mutually exclusive. For example, there could be other MFOs that uses the self help group model, but serves clients in the urban setting. As such, the organizations studied portray these specific strengths in the two primary relationships because of the particular compilation of variables.

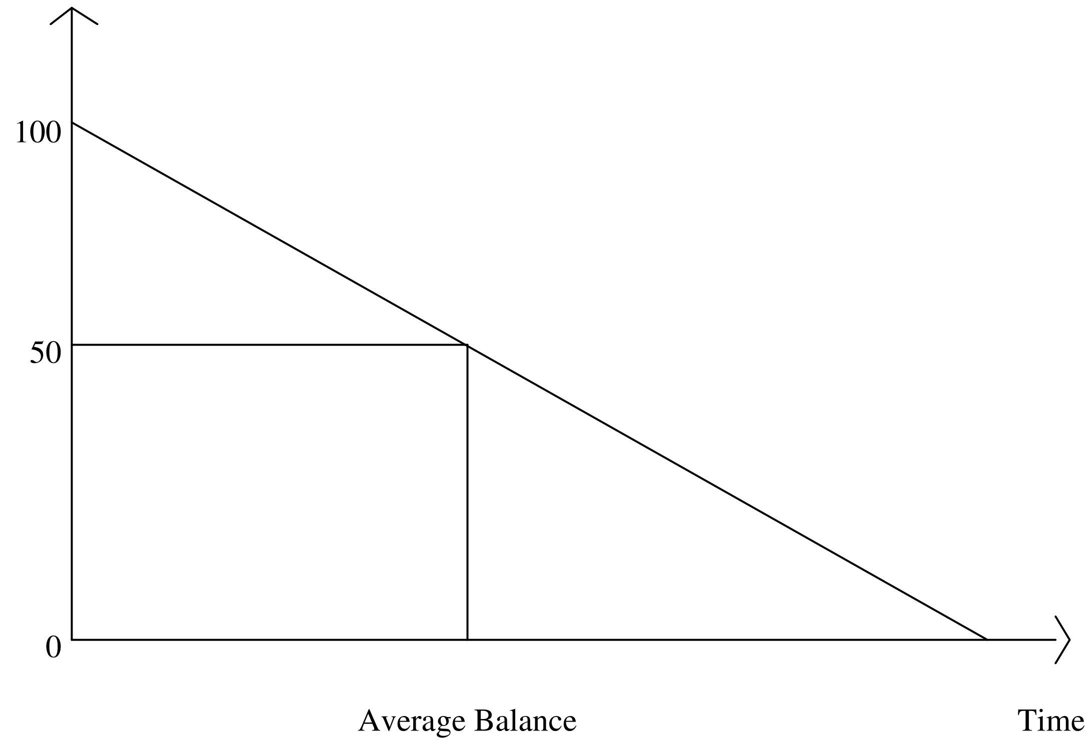
Therefore, there is much room for further research. One way in which this studied could be enhanced is through conducting interviews of larger sample sized of each organization. In addition, a different approach of utilizing a control group could be undertaken. Therefore, rather than studying two organizations with almost all variables that have different characteristics, the organizations can be determined based on a certain number of variables with differing characteristics and a certain number of controlled characteristics. As such, the strength of the relationships can be determined in a manner that does not involve the analysis of each variable as mutually exclusive from the others. Therefore, a larger scale field research of this study could greatly contribute to the understanding of what factors of the four stylized features affect the strength of the two primary relationships and how.

Despite these limitations however, the analysis of the strength of the two primary relationships in the practice of microfinance do have larger implications. By recognizing these factors as those that affect the strength of either the relationship between the MFO and its clients or the intra client group relationships, microfinance practitioners can choose more carefully the variables that come together to form a microfinance-providing organization. If aware of the role each of these factors plays in affecting the central relationships of microfinance, practitioners can attempt to compile variables that lead to the most optimal organization structure possible in order to foster strong relationships between and among the MFO and clients. In addition, in recognizing which factors and how those factors affect the primary relationships can assist current microfinance practitioners in altering the existing factors that affect the four stylized features: accessibility to and reliability of financial services, the information-based lending system, the client group model, and cooperation and participation within the client groups.

Appendix

The following graph, table, and calculations serve as an explanation for the higher effective interest rates incurred from the annual flat interest rate.

One Year



12 %	Flat Annual Interest Rate on $100	$ 12
	But Average Balance	$ 50
	True Effective Interest Rate	24 %

Calculation of Portfolio Earnings:

Equation: $$\frac{\text{Interest Earned on Loans}}{\text{Loan Portfolio}} = \text{Portfolio Earnings}$$

$$\text{Loan Portfolio} = \frac{\text{Loan Portfolio}_{2007} + \text{Loan Portfolio}_{2008}}{2}$$

All figures were obtained from the respective financial reports as reported on the MIX Market Website.

S.M.I.L.E. Microfinance Limited
Portfolio Earnings:

$$\frac{\$2,603,797}{\$12,984,587} = .20053$$

BFL
Portfolio Earnings:

$$\frac{\$3,248,825}{\$20,628,689} = .15749$$

Test Instrument: Interview Questions

Interview questions for loan recipients:

1. When did you first start taking out loans from S.M.I.L.E./ BFL?
2. What type of a business do you run with your microfinance loans?
3. What is your repayment schedule? How often do you repay loans?
4. Do you take out graduated loans? Do the loans increase consistently?
5. Have you ever missed a loan repayment?
6. To what do you attribute the success of your repayments?
7. How do you manage your finances? Do you keep a strict log-book, does someone help you keep track, etc.?
8. Do you set aside a certain amount in savings?
9. How important is the group system (social collateral) of the microfinance structure?
10. Is the group system of help to you?
11. Have you had to repay someone else's loan payment because she could not meet the repayment requirement for some reason?
12. How does such repayment coverage for another recipient in the group affect the group dynamics?
13. Why did you join (S.M.I.L.E./ BFL)?
14. How did you join (S.M.I.L.E./ BFL)?
    a. Who approached who (in terms of the client versus the organization staff)?
15. Are they (the organization) doing as they promised?
16. Are most of the women in your community part of a SHG/JLG?
17. Before and after being a microfinance client:
    a. Difference in income?
    b. Difference in savings?

Interview questions for microfinance bank officials:

1. What is your position within the bank? (administrative, field worker, etc.?)
2. How often do you directly interact with the loan recipients?
3. How often do loan recipients default on loan repayments?
4. What are the reasons for their inability to repay their loans within the given timeframe?
5. Are these reasons common across the board or more region/ethnic/etc. specific?
6. Do you think the reason(s) can be addressed by a change in the microfinance program structure (i.e. loan repayment schedules)?
7. Do you think the reason(s) can be addressed with supplemental programs?
8. Do the loan recipients work out repayment strategies among themselves in the case of default or do they come directly to the bank?
9. Are you made aware of the specific recipient who is unable to repay the loan or does the group collectively cover for her?
10. How does defaulting of loan repayments affect the group (social collateral) structure?
11. What do the clients say they take the loans for?
12. Do they actually use it for that purpose?

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